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A TREATISE

ON THE LAW OF

CORPORATE BONDS AND MORTGAGES

BEING THE

THIRD EDITION OF "RAILROAD SECURITIES," REVISED.

BY

LEONARD A. JONES, A. B., LL. B. [Harv.]

AUTHOR OF LEGAL TREATISES AND JUDGE OF THE LAND COURT OF MASSACHUSETTS.

INDIANAPOLIS

THE BOBBS-MERRILL COMPANY

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TO THE HONORABLE

JOHN F. DILLON, LL. D.,

Judge of the Circuit Court of the United States,

IN TESTIMONY OF THE ESTEEM WHICH THE AUTHOR SHARES WITH THE PROFESSION FOR HIS JUDICIAL OPINIONS AND LEGAL WRITINGS UPON THE SUBJECTS HERE CONSIDERED,

This Treatise

IS INSCRIBED.

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PREFACE.

TWENTY-EIGHT years ago writing the Preface to the first edition of this work published in 1879, I said: The securities considered in this book are of quite recent origin. For the most part they are the outgrowth of the recent extraordinary development of the railroad system of this country. Prior to the year 1860, the courts had only in a few instances been called upon to enforce Railroad Mortgages; and the cases adjudicated since the year 1870 are far more numerous than all that have been decided before that time. It could therefore hardly be expected that the law of the subject should in so short a time have developed into a complete and harmonious system. Yet it seems that no very important divisions of the subject remain unconsidered; while the leading principles of the law have been as fully and conclusively settled as they will be after a century of adjudications. It has been a very fortunate circumstance in the growth of this branch of jurisprudence that the courts leading the way in it have generally been of the highest authority, both in position and ability. The Supreme Courts and the several Circuit Courts of the United States have, directly and indirectly, had the larger share of the responsibility of molding the law of these securities; and hence there is less diversity of opinion in it than there would have been had the courts of the several states in the first place passed upon the subjects independently.

In the Preface to the second edition published in 1890, I said: A change has been made in the title in order more accurately to indicate the scope of the work; for while a large proportion of the cases cited and commented upon relate to bonds and mortgages of railroad corporations, all cases relating to other corporate bonds and mortgages have been sought for, cited, and commented upon with

equal diligence. The work is in fact a continuation of the author's work on "Mortgages of Real Property," and applies the general principles of the law to all mortgages made by corporations.

In regard to the present edition, I may properly say that while the law relating to Railroad Securities had already become in a large part well defined and established, numerous decisions of secondary importance relating to these securities have been rendered in recent years; but in the meantime there has been a wonderful development in the use of corporate organizations in all kinds of business enterprises. It may now be said that the business of the country is in a great part carried on by corporations. The legal questions arising under railroad mortgages are in part the same that arise under mortgages by other corporations; but they are different so far as other corporations were not created for public service and owe no duties to the public.

In the preparation of the present edition, I have availed myself of the valuable and efficient services of Frank N. Morrill, Esquire, formerly of the Boston bar and now a lecturer in the Kansas City School of Law.

Boston, May 1, 1907. L. A. J.

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§ 283. A corporation may, as a matter of course, indorse negotiable instruments which it has taken in the course of business.
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§ 290. It is the duty of trustees intrusted with the sale of lands for the benefit of the bondholders to make the sales as available as possible for the extinction of the debt.
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§ 292. The trustees have no right, without the consent of the bondholders, to waive a default.

§ 293. A mortgage trustee while in possession of a railroad under the mortgage is a trustee of the corporation.
§ 294. The trustee represent the bondholders in suits affecting the mortgage security.
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§ 298. Bondholders may maintain a bill to compel the mortgage trustees to take possession.

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§ 300. Notice, however, to trustees who take a conveyance for the mere purpose of upholding an estate.

III. *Rights of Mortgage Trustees in Possession.*

§ 301. Mortgage trustees on taking possession can use the franchise so far as necessary.
§ 302. In like manner when mortgage trustees obtain an absolute foreclosure by writ of entry and possession for three years, they hold this absolute title in trust.
§ 303. Mortgage trustees entitled to possession of the road under a decree are entitled to the earnings.
§ 304. The trustees may lease a road the title to which they have gained by strict foreclosure.
§ 305. No right of set-off can accrue against the trustees under a mortgage after they have entered into possession.
§ 306. Trustees for bondholders retain their trusts so long as it has not been fulfilled.
§ 307. Mortgage trustees in possession are liable as common carriers.

IV. *Removal of Trustees and Filling of Vacancies.*

§ 308. A court of equity may remove a non-resident trustee.

§ 309. A trustee under a railroad mortgage who unvoluntarily removes to a foreign country and becomes a resident there incapacitates himself.
§ 310. A minority of the bondholders may take proceedings for the removal of trustees.
§ 311. A trustee under two railroad mortgages will not be removed.
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II. *Changes in Form and Amount of Debt.*

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§ 320. But if a bondholder gives up his bonds and accepts other securities in their place.
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§ 321. When the amount of a mortgage is limited to a definite sum, this cannot be enlarged.
§ 322. The debt secured cannot be increased as against subsequent incumbrancers.
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§ 325. A company may purchase its own bonds as an investment, and reissue them.

§ 326. Bondholders are not obliged to accept payment until their bonds are due by their terms.
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III. *Payment of Lost Bonds.*

§ 327. The loss of a bond is no objection to the payment of it.

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§ 329. Relief can be had by one who has paid a prior mortgage, under the belief that he had a good title to the mortgaged property.
§ 330. Subrogation to rights of a state.
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§ 332. But there can be no subrogation as against a state which has issued its own bonds to a railroad company to aid its construction, in behalf of a holder.
§ 333. A statutory lien reserved to a state to secure its bonds loaned to a railroad company is a security for the holders of such bonds.
§ 334. A statutory lien in favor of a state may by the terms of the statutes be a security for the holders of the bonds.

V. *Redemption.*

§ 335. Statutory right of redemption.
§ 335a. Right of junior mortgagee to redeem.
§ 336. A franchise sold under foreclosure is not subject to redemption.
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I. *The Several Remedies to enforce Corporate Securities are Cumulative.*

§ 338. General Statement.
§ 338a. A guarantor of the debt of a corporation, as collateral security for which mortgage bonds of the corporation are deposited.
§ 339. Although a mortgage itself provides no remedy other than a power of sale.
§ 339a. Though the trusts deed gives a power of sale after advertisement only on request of seventy-five per cent. of the amount of bonds secured.

§ 340. Suit at law upon the bonds.
§ 340a. Right of action on bond taken away by provision in mortgage.
§ 341. Recovery of possession.
§ 342. Possession must be taken of the whole property.
§ 343. The remedy at law for the recovery of possession is in most cases inadequate.
§ 344. Upon default a mortgage trustee is entitled to possession as against a contractor in possession.
§ 345. A threatened injury to mortgaged property may be restrained.
§ 346. A general creditor of a corporation cannot obtain an injunction against its executing a mortgage.
§ 346a. Mortgagees may maintain a suit for an injunction to prevent acts tending to disperse the property.
§ 347. A railroad company has no right as against its mortgagee to take up any part of the mortgaged road.
§ 348. A state cannot be sued except.
§ 349. A state, by owning the majority of the stock of a railroad company and pledging its stock to secure second mortgage bondholders, does not become a trustee for such bondholders.

II. *Jurisdiction of State and Federal Courts of Suits against Corporations.*

§ 350. A corporation is not amenable to process except in the state in which it is established.
§ 351. A corporation is foreign to any state only when it owes its corporate existence in no part.
§ 352. A corporation already existing in one state may be invested with corporate rights and privileges by the legislature of another state.
§ 353. A state cannot, however, by mere legislative declaration, make all foreign corporations domestic corporations of such state.
§ 354. For the purpose of federal jurisdiction, a corporation is conclusively considered to be a citizen of the state which created it.
§ 355. A corporation created by the laws of two states may be sued by a citizen of one of these states in the federal court for the other state.
§ 356. The federal courts have jurisdiction of suits against counties and municipalities.
§357. The federal courts have no jurisdiction of actions between states and their own corporations.
§ 358. Where a railroad company which maintains a continuous line of road through several states holds charters from each of the states.
§ 359. When two or more states have by concurrent legislation united in creating one and the same railroad corporation.
§ 360. When a mortgage executed by a railroad corporation organized under the laws of two or more states, covering its entire road and franchises, is foreclosed.

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§ 361. When two or more corporations organized under the laws of the same state are consolidated.
§ 362. Whether a consolidation of railroad companies works a dissolution of the old companies.
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§ 364. A consolidated company is the successor of each of the old companies.
§ 365. Where the articles of consolidation of two railway companies provide that the new company shall assume the debts.
§ 366. A consolidated company is not the same as one of its constituents as regards an executory contract with a stranger.
§ 367. A new company formed by consolidation under statutory authority is not entitled to an exemption from taxation.
§ 367a. A "succession" takes place when the property and franchises of a corporation are purchased at private sale.
§ 367b. After its dissolution a bill to foreclose, filed by the trustee in a mortgage or deed of trust, cannot be maintained.

IV. *In Cases of Concurrent Jurisdiction, the Court which first assumes Jurisdiction retains it.*

§ 368. Where two or more courts have concurrent jurisdiction of the same subject-matter of litigation, that in which suit is first brought.
§ 369. The court having control of the main suit has of course direct control of the receiver appointed in the case.
§ 370. Proceedings in a second foreclosure suit pending the prior suit.
§ 371. The pendency of a foreclosure suit in a state court is no bar to a suit in a federal court.

V. *Sale of Franchise or Property of Railroad Company on Execution.*

§ 372. The franchise of a railroad company.
§ 372a. By the Constitution of Texas the real and personal property of any railroad corporation, or any part of it, shall be liable to execution.
§ 373. The mere fact that the property of a railroad is subject to a mortgage does not operate to exempt such property.
§ 374. Any property which is a part of a railroad mortgaged as an entire property is exempt from execution.
§ 375. But in Minnesota personal property not rolling stock or appertaining to the road may be seized upon execution.
§ 376. In a sale of property to a railroad company a stipulation as to the time of the passing of title is binding.
§ 377. The appropriate remedy of a judgment creditor against a railroad corporation is by application to a court of equity.

§ 378. Statutory provisions for enforcing executions against railroad companies.
§ 379. Funds in possession of the president, officers, and agents of a railroad company are not subject to garnishment.
§ 380. Ordinarily a general creditor of a corporation may reach and apply to his debt moneys belonging to the corporation.

CHAPTER XIII.

FORECLOSURE PROCEEDINGS UNDER CORPORATE MORTGAGES.

I. *Default must be Shown.*

§ 381. A default within the terms of the mortgage must be set forth in the bill.
§ 382. If the principal of the mortgage be not due, but interest is due.
§ 382a. In foreclosure for default in payment of interest.
§ 382b. Upon failure to pay or discharge an execution levied or sued out.
§ 382c. Failure to reimburse a fund out of which interest is payable.
§ 383. A demand of the interest payable may be necessary under the trust deed to constitute a default.
§ 384. Corporation mortgages generally provide that a default shall have continued for a period named.
§ 385. An action to foreclose a mortgage may be brought immediately upon a default.

II. *Parties Plaintiff.*

§ 386. The mortgage trustee, although he does not himself own any part of the mortgage debt.
§ 387. If there are two or more mortgage trustees they should join in the foreclosure suit.
§ 388. A single bondholder, unless restrained by the terms of the mortgage, may maintain a bill in equity to foreclose a mortgage.
§ 389. A single bondholder may insist upon a foreclosure although the mortgage provides for a sale by the trustee upon request of the majority of the bondholders.
§ 390. A holder of bonds payable to bearer is an original payee.
§ 391. When trustees for bondholders have received money applicable to the payment of the bonds.
§ 392. It is not necessary that all the bondholders should actually join in the suit.
§ 393. A single bondholder cannot reach the property conveyed to the trustee, by a suit to enforce his individual claim.
§ 394. One who holds bonds of a railroad company as collateral.
§ 395. After individual bondholders have filed a bill to foreclose a mortgage in behalf of themselves and all others in like interest, the trustees to whom the mortgage was made may come in.

§ 396. When a railroad company mortgages its property directly to all its bondholders by name.
§ 397. A suit by trustees or a part of the bondholders to foreclose a mortgage prevents the running of the statute of limitations as to all the bondholders.

III. *Parties Defendant.*

§ 398. The bondholders for whose benefit a mortgage of the property and franchises of a railroad company has been made to trustees.
§ 398a. As a general rule the trustee of a railroad mortgage represents all the bondholders.
§ 399. A state which has indorsed the bonds of a railroad company, and has a statutory lien upon.
§ 399a. State aid bonds issued to assist in the construction of a railway and indorsed by the railway company.
§ 399b. Partial payment of a bonded debt by a surety does not make him an indispensable or even a proper party to a suit.
§ 400. Whether the United States can compulsorily be made a defendant.
§ 400a. A guarantor of mortgage bonds.
§ 401. A subsequent mortgagee.
§ 402. In a foreclosure suit by bondholders holding lands secured by a first mortgage on part of the road, and by a second mortgage on the rest.
§ 403. Subsequent judgment creditors.
§ 404. As a general rule it is neither necessary nor proper to make prior mortgagees parties.
§ 404a. To make the prior mortgagee a party, unless there is a voluntary appearance, there must be a service of process upon him.
§ 405. When a foreclosure is sought subject to prior liens.
§ 406. In a suit to foreclose a mortgage, a prior mortgagee of a part of the property may be made a party.
§ 407. Priority of title may be tried in the foreclosure suit.
§ 408. Unsecured creditors of a corporation are not necessary or proper parties.
§ 408a. Lessees under a lease executed subsequent to a mortgage.
§ 408b. Under an ordinary mortgage of real estate, claims in antagonism to both mortgagor and mortgagee.
§ 409. A temporary receiver of a corporation, appointed in an action by the attorney general to dissolve it.
§ 409a. The right of minority stockholders of a corporation to intervene in a foreclosure suit.
§ 410. Individual stockholders are not generally allowed to become parties.
§ 411. Where a stockholder may intervene.
§ 411a. A state is not exempt.
§ 412. Adverse interests as between co-defendants may be passed upon and decided.

§ 413. It is a general rule that strangers to a cause cannot be heard.

IV. *Defenses.*

§ 414. In general.
§ 415. A junior mortgagee cannot deny the validity of a prior mortgage which he has assumed.
§ 416. Subsequent contracts of the company.
§ 416a. Whether complainants are conducting a foreclosure suit from good or bad motives.
§ 416b. A tender of money due on a bond.

V. *Decrees.*

§ 417. Decree of sale of railroad situate in two states.
§ 418. Decrees entered by consent.
§ 419. When a decree made by consent is beyond the scope of the original bill.
§ 420. Final decree.
§ 421. There may also be a final decree in a matter distinct from the general subject of litigation.
§ 421a. A court of equity has the power so to mould its decree as to order a sale.
§ 422. A decree for the sale of a railroad under foreclosure proceedings should name an upset price.
§ 423. The court which has entered a decree of sale of a railroad may, in its discretion, delay the sale.
§ 424. Liability on supersedeas bond.
§ 424a. Bonds need not be put in evidence prior to a decree of foreclosure and sale.
§ 424b. On a sale under decree of foreclosure.
§ 424c. A covenant that trustees should be allowed all necessary expenses for attorney and counsel fees.

CHAPTER XIV.

THE APPOINTMENT AND JURISDICTION OF RECEIVERS.

I. *Grounds for the Appointment of Receivers.*

§ 425. The English rule in regard to the appointment of receivers at the suit of a mortgagee.
§ 426. In the United States, courts of equity have exercised their powers with much more freedom.
§ 427. A state statute, which takes from the mortgagee the right of possession until foreclosure, governs a federal court sitting in the state.
§ 428. The appointment of a receiver is an equitable remedy.

§ 429. A railroad company cannot itself properly ask for the appointment of receivers.
§ 430. Upon an application for a receiver by mortgage creditors, it is generally necessary to show something more than the fact that a default has occurred.
§ 431. But a mere default is a sufficient ground for the appointment of a receiver where the mortgage in terms covers the income and profits.
§ 432. Ordinarily a receiver will not be appointed in behalf of a mortgagee until a right of foreclosure exists.
§ 433. Where, however, a default is imminent and manifestly inevitable.
§ 434. A judgment creditor may have a receiver appointed to protect his interests.
§ 435. Mismanagement alone of the property by the mortgagor is no ground for the appointment of a receiver.
§ 436. A receiver will not be appointed when the mortgagee has a complete and adequate remedy at law.
§ 437. Whether a receiver should be appointed is a question often attended with difficulty.
§ 438. That a receiver will not be appointed upon the application of a mortgagee, as a matter of course, upon a default.
§ 439. A receiver will not be appointed against the wishes and interests of a great majority of the bondholders.
§ 440. In a case where it was shown that no interest had been paid on the first mortgage bonds of a railroad company for about ten years.
§ 440a. That suit for a receivership has been brought by minority stockholders.
§ 441. That the mortgaged property is liable to be seized on execution.
§ 441a. The conduct of the officers of a corporation may be such as to require the appointment of a receiver.
§ 442. The application of the income of a road to completing and operating it is not a misapplication of the funds of the road which calls for the appointment of a receiver.
§ 443. Refusal of trustees to perform the trust.
§ 444. A receiver may in some cases be appointed merely for the purpose of securing the profits.
§ 445. A receiver will be appointed to collect and disburse the income pending a sale under a decree.
§ 446. Appointment of receiver of insolvent corporation to sell its property.
§ 447. Appointment of receiver to operate road.
§ 447a. A railway company may properly be put in the hands of a receiver after a judgment forfeiting its charter obtained by the state.
§ 448. The president and directors of a railroad company may be continued in possession of the property as receivers.
§ 449. When property is in the hands of trustees who hold their office ex officio as high public officers of the state.

§ 450. Whether the Supreme Court of the United States would in any case appoint a receiver.
§ 451. The appointment of a receiver in such case may, perhaps, be more appropriately made by the Circuit Court.
§ 451a. Right of appeal from interlocutory order.
§ 452. The general rule to be deduced.
§ 453. As a general rule, a receiver appointed in a prior suit should not be displaced by the appointment in a subsequent suit.
§ 454. As a general rule, a receiver should not be appointed without notice.
§ 455. When an individual bondholder or a judgment creditor seeks the appointment of a receiver.
§ 456. If the mortgaged premises are in the possession of a tenant or lessee.
§ 457. The fact that a corporation is insolvent will not authorize the corporation itself to apply.

II. *Selection of Receivers.*

§ 458. In the appointment the court is not necessarily controlled by the express wish of the parties.
§ 459. It is not unusual for parties representing different interests to agree upon the appointment of two or more receivers.
§ 460. The appointment of a receiver once made cannot be assailed in a collateral proceeding.

III. *Jurisdiction of Receivers.*

§ 461. A receiver's authority is limited to the jurisdiction of the court appointing him.
§ 462. The generally recognized doctrine, however, is that a receiver appointed in one state has no power to institute proceedings in the courts of another state.
§ 462a. The burden is upon a receiver appointed by the courts of one state to show he has power and authority to maintain an action in the courts of another state.
§ 463. It is a rule of law in all cases of conflict of jurisdiction, that the court which first takes cognizance.
§ 464. Where the conflict of jurisdiction does not relate to the cause, but to the possession of the subject-matter.
§ 465. The mere filing of the bill may give jurisdiction of the thing in controversy.
§ 466. When a receiver has once obtained actual possession of the property committed to his charge, he cannot be interfered.
§ 467. When, however, a line of railway extending through several states belongs to the same corporate body.
§ 468. Two or more states may, by concurrent legislation, unite in creating the same corporate body.

§ 469. Receivers of a railroad appointed by one jurisdiction are not entitled, as of right, to recognition in other jurisdictions.
§ 470. A receiver appointed by a court having jurisdiction of the cause cannot be interfered with by a court of coordinate jurisdiction.
§ 471. A sale of property under process of one court, while the same is in the possession of a receiver appointed by another.
§ 472. By the comity existing between the courts of the different states.
§ 473. When property has once vested in a receiver within the jurisdiction of his appointment he can take it into another state.

CHAPTER XV.

THE RIGHTS AND LIABILITIES OF A RECEIVER.

1. *The Title and Power of a Receiver in General.*

§ 474. The right of a receiver to property placed in his charge relates back to the date of the order of his appointment.
§ 474a. An order for the delivery of "all and every part of the premises, interests, effects, moneys, receipts, and earnings," etc.
§ 475. The court in which the receiver was appointed is the proper tribunal to direct and control the receiver.
§ 475a. When authorized by order of court to continue the business of a railroad company.
§ 476. A receiver takes the property subject to any legal or equitable liens upon.
§ 476a. Every lien upon the property of a corporation resting upon valid agreement or process before the appointment of a receiver.
§ 476b. A court of the United States will not permit its receiver to do any unlawful act.
§ 477. If a receiver collects moneys under a pooling contract with another railroad company, he must account for them in accordance with the contract.
§ 478. If property not recovered by mortgage is taken possession of by receivers together with the mortgaged property.
§ 479. Suits by receivers.
§ 480. The receiver is the proper party in whose name suits should be conducted, either by or against the corporation.
§ 481. A receiver cannot be put in possession of property claimed to belong to the corporation, but in the possession of another, by a summary order.
§ 482. Relation of the receiver to leases of the property.
§ 483. Liability of receiver for rental of leased lines.
§ 483a. That a receiver can never be compelled to take possession of leased lines as assignee.
§ 483b. Liability of receiver upon executory contracts made prior to appointment.

§ 483c. Receivers are allowed a reasonable time to elect whether they will assume any of the corporation's executory contracts.
§ 483d. A fortiori a receiver is not liable for a tort.
§ 484. Whether a receiver may disregard traffic rates.
§ 485. Payments within the discretion of a receiver.
§ 485a. Interest accruing on first mortgage bonds may be paid by a receiver.
§ 486. Contracts entered into by receivers with authority should be strictly fulfilled.
§ 486a. Where a receiver petitions for a reduction of employes' wages.

II. *A Receiver cannot be sued without leave of the court appointing him.*

§ 487. In general.
§ 488. In what courts a receiver may be sued.
§ 489. This rule applies both to suits for the recovery of money demands and those for the recovery of damages.
§ 490. A court making the appointment of a receiver may draw to itself all controversies to which the receiver is a party.
§ 491. The court in which the original bill was filed, when ancillary bills have been filed.
§ 492. The court appointing a receiver may by a general order permit the receiver to be used in any court.
§ 493. The usual course in obtaining leave to sue a receiver is.
§ 493a. Permission to sue a receiver appointed by a federal court is now given by Act of Congress.
§ 493b. Under the Texas Statute giving a right of action for injuries resulting in death.
§ 494. The proper remedies against a receiver.
§ 495. A statute authorizing suits against receivers does not avail against this rule.
§ 496. An execution cannot be levied upon property in the hands of a receiver.
§ 497. Any wilful interference with a receiver in the possession of the property placed in his charge is a contempt.
§ 498. Strikers are guilty of contempt of court if, without actual violence, they resort to threats.
§ 499. There are not wanting instances in which courts, jealous of their power and jurisdiction, have denied the rule.
§ 500. The courts of Wisconsin and Iowa have also departed from this doctrine.
§ 501. These cases were assailed with much vigor, and their doctrine denied.
§ 501a. A statute regarding the appointment of agents to accept service of summons.

III. *A Receiver's Liability to Suit for the Negligence of his Employes.*

§ 502. A receiver is liable in his official capacity for the negligence of his employes.

§ 502a. A receivership is continuous and is analogous to a corporation sole.
§ 503. A receiver, though empowered by statute to operate a railroad of an insolvent company for the use of the public, is not a public officer.
§ 504. In some states it is no defense at law that the defendant is a receiver.
§ 505. In some states, moreover, a court of law may exercise jurisdiction in such case without leave being previously.
§ 506. After judgment has been obtained at law, the fund in the hands of the court whose officer the receiver is cannot be reached without leave of that court.
§ 507. The better rule, apart from the enabling statute, is that a receiver, though engaged in the business of a common carrier, cannot be sued without leave of the court of equity.
§ 508. The determination of questions of fact by a court of equity does not impair the constitutional right of trial by jury.
§ 509. The equity court may in its discretion, where the facts are in dispute, allow the receiver to be sued at law.
§ 510. The receiver is entitled to set up any defense to such action that would be available to the corporation itself.
§ 510a. A requirement for notice to receivers within six months of the happening of an injury.
§ 510b. A state "fellow servant act."
§ 511. A receiver is not personally liable for injuries done through the neglect or misconduct of those employed by him.
§ 512. Receivers who have wilfully and corruptly exceeded their power are liable for the actual damage sustained.
§ 513. A receiver is responsible individually for the careful management of property over which he has no control as receiver.
§ 514. A judgment for negligence cannot be enforced as against the rights of mortgagees.
§ 515. A receiver is not liable for anything occurring after his title and possession have been duly terminated.
§ 516. The discharge of a receiver operates as a discharge of the property for torts.

IV. *The Company itself is not liable after the Receiver has assumed Control.*

§ 517. The railroad company itself, whose property is in the hands of a receiver, is not ordinarily liable.
§ 518. But unless the possession of the receiver under a decree of court is exclusive.
§ 519. In determining the question whether the corporation is liable for injuries done after the appointment of a receiver.
§ 520. When suit allowed against company for receiver's acts.
§ 520a. Recognized exceptions to the rule that a railway company is not responsible for the acts of a receiver.
§ 521. Liability of company as affected by statute.

§ 522. A special receiver or assignee of the property of a railroad corporation, appointed in bankruptcy proceedings, involuntary on its part, is not an agent or servant of the corporation.
§ 522a. Where a tort claim arises after a sale on foreclosure but before confirmation.

V. *Discharge and Removal of Receiver.*

§ 523. A receiver will be discharged when it appears that the security of the creditor no longer requires his continuance.
§ 524. The discharge of a receiver, like his appointment, is ordinarily a matter resting wholly within the discretion of the court.
§ 525. After a receiver has been discharged from his office, the court that appointed him has no power to proceed summarily against him.
§ 526. Upon a motion to vacate an order previously made appointing a receiver he should not be heard in opposition.
§ 527. The rescission of an order appointing a receiver after the commencement of an action of replevin or possessory warrant against him.
§ 528. Specific complaints against a receiver of maladministration of his trust will receive the attention of the court.
§ 529. It is ground for the removal of two receivers of a railroad that they have become hostile to each other.
§ 530. The court will remove receivers who abuse their trust by using it to advance their own interests.

VI. *Compensation and Account of Receiver.*

§ 531. The question of the compensation to be allowed a receiver is one that properly belongs to the master.
§ 532. The amount of compensation.
§ 532a. The compensation of receivers should be restrained to reasonable charges.
§ 533. If the duties of the receiver prove to be more arduous than was anticipated.
§ 534. If the fund in court is not sufficient to afford compensation to the receivers.
§ 535. A receiver's expense for counsel and witness fees, incurred in resisting a motion for his removal.
§ 536. The receiver's legal adviser.
§ 537. Allowances of counsel fees out of the fund in the hands of the court.
§ 538. If complainants' counsel present claims for professional services for allowance during the pendency of a receivership.
§ 539. What payments and expenses a receiver may charge.
§ 540. A receiver may appeal from a decree directing him to pay into court a certain sum as the balance due from him.

CHAPTER XVI.

RECEIVER'S DEBTS AND CERTIFICATES.

I. *For what Purposes Receivers may be authorized to incur Debts and issue Certificates.*

§ 541. General principles.
§ 542. The receiver has no power, without the authority of the court whose officer he is, to make a contract.
§ 543. The legitimate object of a court of equity in the assumption of the management of a railroad is the preservation of the property.
§ 544. To preserve the road as a whole, and to prevent loss or depreciation, it may be necessary to rebuild, or even to build anew.
§ 545. But the court will not authorize expenditures for the completion of a road unless it is morally certain that the property in consequence will sell for a higher price.
§ 546. The proper functions of a court of chancery in the management of a railroad through a receiver.
§ 547. As a general proposition it may be said that the necessity of the expenditure is the criterion of its propriety.
§ 547a. However under special circumstances it was held proper for a receiver.
§ 548. A receiver may be authorized to take a lease of another railroad.
§ 549. When it is necessary for the receiver to raise money for the purpose of repairing or operating a railroad, the court may authorize him to issue negotiable certificates of indebtedness.
§ 550. Such certificates may be issued for material furnished.

II. *Priority of Receivers' Certificates.*

§ 551. The question of the priority of receivers' certificates and loans over existing mortgage liens.
§ 551a. For the preservation and management of the property the court may authorize a receiver to borrow money and to make the loan a lien upon the property.
§ 552. When bondholders, or trustees in their behalf, after obtaining the appointment of receivers, have petitioned that they might be allowed to borrow money on the credit of the property.
§ 552a. Receivers' certificates take preference over a valid lien for rails furnished a road.
§ 553. When receivers have obtained loans upon the credit of the property with the knowledge and assent of all the parties interested.
§ 554. Upon the question of the power of courts to give receivers' loans precedence over existing mortgages.
§ 555. As regards the debts which receivers may incur, cases arising under railroad receiverships are to be distinguished from all others.
§ 555a. The issue of first lien certificates by receivers is an extraordinary power, to be exercised only in cases of railroads.

§ 556. Receivers' certificates are subject to the right of parties having prior liens who have not been brought before the court.
§ 557. A receiver contracting debts under a consent order merely acts as the agent of the consenting bondholders.
§ 558. The courts may place the burden of doubtful expenditures upon the bondholders who ask for them.
§ 559. The court cannot, by authorizing a receiver to create liens upon the property, displace or impair the mortgagee's rights of property.
§ 560. Receiver's debts, and claims against him for services, supplies, and the expenses of management, cannot ordinarily be paid out of the proceeds of the mortgaged property.
§ 561. The court cannot authorize receivers' certificates for the payment of labor and services in operating the road prior to their appointment.
§ 562. When receivers' certificates are issued on orders made without prior notice.
§ 563. Neither the mortgagor nor his assignees can question the priority of receivers' certificates.
§ 564. Provision is made by statute in a few states.
§ 564a. Receivers' certificates cannot be enforced in a separate proceeding.

III. *Negotiability of Receivers' Certificates.*

§ 565. Such certificates, however, are not commercial paper.
§ 566. Certificates issued without consideration are invalid.

CHAPTER XVII.

DEBTS OF MORTGAGE TRUSTEES IN POSSESSION.

I. *Right of Trustees to Repayment of their Debts and Expenses out of the Trust Fund.*

§ 567. Trustees under corporate mortgages have an inherent equitable right to be reimbursed all expenses reasonably incurred.
§ 568. When the object of a receivership has been accomplished, and the occasion for it no longer exists, but it is nevertheless continued, in form and name.
§ 569. These points are forcibly illustrated by the case of the Vermont Central Railroad Company.
§ 570. Debts contracted by trustees in possession for completing the road.
§ 571. If mortgage trustees have paid for the protection of the trust property a prior incumbrance, they are subrogated to the lien of that incumbrance.
§ 572. A creditor or other person not holding the position of trustee has no right to be reimbursed his advances to protect a corporation in preference to mortgage creditors.

§ 572a. Money advanced by an outsider to pay taxes.
§ 573. Compensation of trustees.
§ 574. A foreclosure decree rendered in a circuit court fixing the compensation of the trustees is a final decree.
§ 575. The funds in the hands of a receiver are chargeable with the retainer and professional services of an attorney employed by the trustees.
§ 576. A bondholder who in good faith files a bill for the common benefit of all the bondholders is entitled to be paid his costs, counsel fees, and necessary expenses.
§ 577. Trustees managing a railroad are not liable for the use and occupation of land outside the location.

II. *Liability of Trustees operating a Railroad as Common Carriers.*

§ 578. Trustees operating a railroad for the benefit of the bondholders are regarded as owners.

CHAPTER XVIII.

THE PRIORITY OF RAILROAD MORTGAGES AS AFFECTED BY EQUITIES ARISING SUBSEQUENTLY.

I. *Equities of Employes.*

§ 579. General Statement.
§ 580. The most reasonable ground upon which a chancery court can order a receiver to pay the wages of employes of a railroad company.
§ 581. The court lay stress upon the meritorious character of the claims of the employes.
§ 581a. A claim by a merchant for rations furnished to laborers.
§ 582. It sometimes happens that mortgage creditors find it a matter of policy to assume the payment of certain general debts.
§ 583. In no case had any one of the federal courts allowed claims for supplies or for labor in preference to existing mortgages.

II. *Equities of Contractors and Material-Men.*

§ 584. It has sometimes been sought to establish equities in favor of those who have furnished material or money for building or repairing of railroads.
§ 585. A mortgage by a railway company of their "road, built and to be built," has precedence, even as regards the unbuilt part, of the claim of a contractor.
§ 586. The order of priority of two or more railway mortgages is not affected by the fact that a part of the road was wholly built by money raised by means of the junior mortgage.

§ 587. A claim for materials furnished an insolvent railway company, which is not a lien by virtue of any statute.
§ 588. Advances made to pay for rolling stock.
§ 588a. The North Carolina statute.

III. *Equities of Claims for Operating Expenses.*

§ 589. A court of equity may make it a condition of its issuing an order for the appointment of a receiver.
§ 589a. However, the appointment of a receiver vests in the court no absolute control over the property and no general authority to displace vested contract liens.
§ 590. This equity for the payment of operating expenses may be enforced, though their payment be not provided for in the order appointing the receiver.
§ 591. Although the mortgagor has been allowed to remain in possession and has applied the income to other purposes.
§ 592. A diversion of the earnings of a railroad from the payment of operating expenses to the payment of interest.
§ 593. As regards this doctrine, there is a vital distinction between a debt for construction and one for operating expenses.
§ 593a. The term "original construction."
§ 594. The class of preferred debts to be so paid.
§ 595. On this ground the attorney of a railroad company is entitled to the payment of his annual salary.
§ 595a. Three things necessary to give a preference against a railroad company, in the hands of a receiver.
§ 596. Under this principle are also included the payment of limited amounts due to connecting roads.
§ 597. This principle has been extended to the protection of one who has rescued the mortgaged property.
§ 598. On this principle, bondholders who have advanced money necessary for the payment of wages.
§ 599. But a general loan is not entitled to such preference.
§ 600. A claim for rent of cars during a receivership may be charged upon the income.
§ 600a. Rental for track privilege accruing prior to the appointment of a receiver.
§ 601. In exceptional cases claims not for operating expenses may have an equity as against the mortgage lien.
§ 602. No equitable lien arises in behalf of a general creditor in consequence of the receiver's applying net income to permanent improvements.
§ 603. Claims against a railroad company as a common carrier for damages to passengers or property are not operating expenses.
§ 604. Preferred debts for work done and materials furnished are a lien upon all the divisions of the system.

§ 605. The purchasers of privileged claims have the same right to payment that the original holders had.
§ 606. The doctrine of Fosdick v. Schall has rarely been applied to any case other than that of a railroad.
§ 606a. There are, however, two cases adopting the opposite view.
§ 606b. In determining what is to be classed as a railway receivership.
§ 607. If there is no income in the receiver's hands after paying the running expenses of the road.
§ 608. The court may in its discretion order a receiver to pay a tax upon the franchise of a railroad company out of the gross earnings.
§ 609. Debts payable out of principal when there has been a diversion of income.
§ 609a. That there must be a diversion of income in order that operating expenses prior to the receivership may be a prior lien against the corpus.
§ 610. Limit of time within which preferred debts must have been incurred.
§ 610a. Loss of preferential lien by laches.
§ 611. Where persons furnished supplies from time to time under a continuous verbal contract.
§ 611a. Right to apportionment of preferential debts.
§ 611b. Prosecuting an action against a railway to final judgment does not forfeit a preferential lien.
§ 611c. A claim for a preferential lien must be presented in a petition for intervention and not by motion.
§ 611d. Since railway corporations cannot sell, lease or mortgage their property without legislative consent.
§ 611e. A mere right to file a mechanic's lien against a railway company under a state statute does not preclude the assertion of an equitable lien.

IV. *Equities under Contracts and Leases made subsequently to Mortgages.*

§ 612. Contracts made by a railroad company subsequently to a mortgage are not binding upon the mortgagees.
§ 613. There is no legal principle by which contracts made by a railroad company, after the execution of a mortgage.
§ 614. A mortgage made after the execution of a lease of the property.
§ 615. A landowner's claim for damages for land taken for the road is paramount to a mortgage.

CHAPTER XIX.

SCHEMES FOR REORGANIZATION AFFECTING THE PRIORITY OF MORTGAGES.

I. *Rights under Agreements for Reorganization.*

§ 616. Schemes for reorganizing corporations.

§ 617. In England and Canada, where there is no constitutional prohibition against laws impairing the obligation of contracts.
§ 618. The rights of bondholders under the mortgage cannot be impaired without their consent by any scheme of reorganization.
§ 618a. Combinations for purchasing at foreclosure sale favored by courts.
§ 619. A bondholder who stays out of a reorganized company may maintain an action against it for an accounting.
§ 620. But while a bondholder's rights are not prejudiced by the scheme. he is not entitled to any greater rights.
§ 620a. Where the powers of a corporation reorganization committee are defined and limited by the reorganization agreement.
§ 620b. In dealing with reorganization agreements, the court will in every case require good faith from the committee representing the bondholders.
§ 620c. Assent by bondholders binds their transferees.
§ 621. A substantial departure from the terms of a compromise agreement.
§ 621a. Failure of bondholders to surrender bonds in accordance with agreement.
§ 622. A party to an agreement for the reorganization of a company cannot set up its secret agreement with himself.
§ 623. Under a scheme to relieve an insolvent railroad company by allowing all its creditors to share on equal terms.
§ 623a. A trustee for bondholders purchasing at foreclosure under a reorganization scheme.

II. *Rights of Preferred Stockholders as against Mortgagees.*

§ 624. Questions of priority have sometimes arisen between preferred stockholders and subsequent mortgagees.
§ 625. Ordinarily preferred shareholders are entitled to have deficiencies of their dividends made up.
§ 626. Preferred stockholders are not creditors.
§ 627. Where a mortgage is given to secure so-called preferred stock.
§ 628. In ascertaining the profits of a railroad company for the purpose of making dividends on preferred shares.
§ 629. Such a question arose in relation to the preferred stock issued by the Erie Railway Company.
§ 630. Preferred dividends payable out of net earnings are not in the nature of interest.
§ 631. One who takes stock in a corporation takes it subject to the control of its directors.
§ 632. The net earnings of a corporation.
§ 633. A definition of net earnings or of expenses contained in the charter of a company and in an agreement for reorganization.

CHAPTER XX.

FORECLOSURE SALES UNDER CORPORATE MORTGAGES.

I. *Sale of Entire Property.*

§ 634. There is no principle of common-law which deprives the owners of property of the right to confer upon a trustee the power to sell.
§ 634a. Under a deed of trust which contemplates but one sale, the entire property may be sold.
§ 634b. Notwithstanding a constitutional provision requiring rolling stock to be treated as personal property.
§ 635. Sale of consolidated road.
§ 636. Sale of road built by new company.
§ 637. When specific property subject to a separate incumbrance can be sold separately.
§ 638. Upon the foreclosure of a mortgage of a railroad and its franchise for a failure to pay an instalment of interest.

II. *Conduct of Sale.*

§ 639. The marshal or other officer, who makes a sale under a decree of foreclosure, is not only invested with a reasonable discretion as to the manner of conducting the sale.
§ 640. A mortgage trustee will be left to exercise his discretion as to the time of making the sale under a decree of foreclosure, and as to making a sale at all.
§ 640a. The fact that a sale advertised for ten o'clock did not occur until some hours later.

III. *What Franchises pass by the Sale.*

§ 641. The franchise of a corporation.
§ 641a. A judgment obtained by a railroad company.
§ 642. A mortgage by a railroad company does not pass any interest in land taken for its right of way which it has failed to pay for.
§ 643. Interest on purchase money.
§ 644. A purchaser at a foreclosure sale under a decree in chancery subjects himself to the jurisdiction of the court.

IV. *Distribution of the Proceeds of Sale.*

§ 645. In the distribution of the proceeds of a foreclosure sale, liens at law have precedence.
§ 646. Every bond is entitled to its pro rata share.
§ 647. In distributing the proceeds of a foreclosure sale, the payment of coupons which matured before a general default may be preferred.
§ 648. One who holds bonds as collateral security should receive only the amount of his loan.

§ 649. Upon the foreclosure of a railroad mortgage, no part of the proceeds of the foreclosure sale can be distributed among the stockholders.
§ 650. Any surplus of proceeds of a foreclosure sale remaining after satisfying the mortgage.

V. *Setting aside of Sale.*

§ 651. Proceedings to set aside as fraudulent a decree of foreclosure and a sale under it, must be commenced within a reasonable time.
§ 651a. Jurisdiction of federal court.
§ 652. A single stockholder may maintain a bill in behalf of the corporation to set aside a sale.
§ 652a. A trustee cannot set aside a foreclosure sale obtained by bondholders.
§ 653. After confirmation of a sale.
§ 654. The right of a corporation to avoid a sale of its property, by reason of the fiduciary relations of the purchaser.
§ 655. A director of a corporation having in good faith made a loan to it, and taken security in the form of a deed of trust of real estate, may properly purchase the property.
§ 656. A sale by a bondholder in fraud of other bondholders will be set aside.
§ 657. A mortgage trustee in possession cannot without express authority become a purchaser.
§ 658. A mortgage trustee may purchase at a foreclosure sale in pursuance of a provision in the mortgage.
§ 658a. A purchase by a receiver in his own name.
§ 659. The fact that the purchaser at a foreclosure sale of the property of a railroad company are bondholders and creditors.
§ 660. The solicitor of a railroad company may purchase its property at a foreclosure sale.
§ 661. A foreclosure sale which has been assented to by the parties in interest cannot afterwards be questioned by them.
§ 662. Inadequacy of price.
§ 663. Purchasers of a railroad at a foreclosure sale, who have conspired with the directors of the road in effecting a fraudulent sale.
§ 663a. Where stockholders in the mortgagor corporation appear to obtain some benefit in the purchasing company.
§ 664. A foreclosure sale will be set aside as fraudulent where it appears that the notice of sale misstated the sum due.
§ 665. A sale before default passes only the mortgage title.
§ 666. The trustee who obtained the decree of sale should be made a party.
§ 667. Compensation to purchaser for repairs and improvements made by him.
§ 667a. Where the purchaser succeeds in having a sale set aside so as to be released from his obligation.
§ 668. Objections to a judicial sale, based upon errors in the decree.
§ 669. The legislature has no power to confirm a fraudulent sale.

CHAPTER XXI.

RIGHTS OF PURCHASERS AT FORECLOSURE SALES UNDER CORPORATE MORTGAGES.

I. *Purchasers are not liable for the Debts of the Old Company.*

§ 670. There is no privity between a new corporation formed in accordance with statute authority by the purchasers of a railroad upon foreclosure, and the old corporation.
§ 671. Purchasers of a railroad under a mortgage or execution sale are not regarded as continuing the old corporation.
§ 672. The franchise to maintain and operate a railroad is distinct from the franchise to be a corporation.
§ 673. The purchaser at a valid foreclosure sale takes the property free of all liens and incumbrances.
§ 674. A new corporation formed by purchasers is not liable for the debts of the old corporation.
§ 675. The effect of a sale of the property and franchises of a railroad company is not different from that of a sale under an ordinary mortgage.
§ 676. A purchaser with notice of a claim or lien of another upon the property.
§ 677. A new corporation is liable for claims which were an equitable lien upon funds received from the mortgage trustees.
§ 677a. Purchasers discharging liens against the property are not entitled to be subrogated.
§ 678. Subject to vendor's lien for purchase money.
§ 679. Damages resulting from the negligence of those operating a road after the time.
§ 680. There may be a condition precedent imposed by statute or decree that the new corporation shall assume the debt of the old.
§ 681. To prove a new promise by the purchasers of a railroad and its franchises to pay a debt owing the original company.
§ 682. Debts incurred by a corporation cannot be released by legislative enactment.
§ 683. Whether, upon a foreclosure sale of property subject to a mortgage, the purchaser can contest the validity of the mortgage.
§ 683a. Ordinarily a transfer on foreclosure sale is made free from the lien of receiver's certificates.
§ 684. Purchasers at a foreclosure sale made expressly subject to the payment of receivers' certificates.
§ 684a. Where the decree of sale provided that all demands accruing during the receivership should be barred unless presented within six months.
§ 685. When purchasers bound by arguments made by receivers.
§ 686. A purchaser or mortgagee of the property of a new corporation which has assumed the debts of the old corporation, with notice of such assumption.

§ 687. Combinations for the purpose of purchasing and reorganizing large properties, such as a railroad, are to be promoted and encouraged.
§ 688. A purchaser under a foreclosure sale who has agreed to purchase for the benefit of a new corporation.
§ 689. Bondholders who purchase at a foreclosure sale under their mortgage have an equitable right to apply their bonds towards the payment of the purchase money.
§ 690. Unsecured creditors of an insolvent railroad company who refuse to come into a scheme of reorganization are without remedy.
§ 691. Bondholders after a foreclosure cannot claim an interest in a reorganized corporation without sharing in the expenses of the sale and reorganization.
§ 692. A constitutional provision against issuing stock or bonds, except for money or property actually received.
§ 693. Whether a purchaser at a foreclosure sale of the franchises, property, and immunities of a railroad company acquires a right of exemption from taxation.
§ 693a. In the absence of express statutory direction.
§ 693b. Power to fix rates does not pass.
§ 694. A purchaser at a foreclosure sale of a railroad takes only the property which the decree directed to be sold.
§ 694a. Where during foreclosure suit, an illegal tax is paid.

II. *Organization of Purchasers into a New Corporation.*

§ 695. Whether individual purchasers can manage the property as individuals.
§ 696. There is some authority to the effect that the corporate existence continues after a foreclosure sale, and that the purchasers become in effect new stockholders.
§ 697. The legislature has full power to authorize the bondholders, for whom the mortgaged property had been purchased at a foreclosure sale, to reorganize as a new corporation.
§ 698. Statutory provisions for incorporating purchasers.

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§ 699. The Bankruptcy Act of 1898.
§ 699a. Railroad companies were within the operation of the Bankruptcy Act.
§ 700. The Bankruptcy Act not inapplicable to corporations on the ground that it provides no discharge for them.
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§ 702. After bankruptcy proceedings had been commenced against a railroad corporation in one of two states.

§ 703. All the franchises of a railroad corporation that are transferable passed to the assignee under the assignment.
§ 704. A railroad company was not a "banker, broker, merchant, trader, manufacturer, or miner."
§ 705. Whether precedence should be given to foreclosure suits or to proceedings in bankruptcy.
§ 706. The Bankruptcy Court had no authority to take property out of the possession of a receiver.
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THE LAW OF CORPORATE BONDS AND MORTGAGES

CHAPTER I.

POWER OF CORPORATIONS TO MORTGAGE THEIR PROPERTY AND FRANCHISES.

I. Legislative authority essential to a mortgage of corporate property and franchises, §§ 1–26.

II. Statutes authorizing railroad companies to mortgage their property and franchises, § 27.

I. Legislative Authority Essential to a Mortgage of Corporate Property and Franchises.

§ 1. **It is a settled doctrine of the English law** that a corporation like a railway company, created for the performance of important public functions, and for that purpose endowed with special rights and privileges, cannot, without legislative authority, transfer these rights and privileges, and thus divest itself of its means of discharging its public duties.[1] "I agree," said Lord Cranworth in the House of Lords, delivering the judgment in the case first cited below, "to the proposition urged by the appellants, that *prima facie* corporate bodies are bound by all contracts under their common seal. When the legislature constitutes a corporation, it gives to that body, *prima facie*, an absolute right of contracting. But this *prima facie* right does not exist in

[1] Shrewsbury &c. R. Co. v. Northwestern R. Co. 6 H. L. 113, 135; Winch v. Birkenhead &c. R. Co. 5 De G. & S. 562; 7 R. & C. Cas. 384; South Yorkshire R. &c. Co. v. Great Northern R. Co. 9 Ex. 55, 84; Great Northern R. Co. v. Eastern Counties R. Co. 21 L. J. Ch. 837; 9 Hare, 306; 7 R. & C. Cas. 643; East Anglian R. Co. v. Eastern Counties R. Co. 11 C. B. 775; 7 R. & C. Cas. 150; Riche v. Ashbury R. &c. Co. L. R. 9 Ex. 224, 264; Bagshaw v. Eastern &c. R. Co. 7 Hare, 114; 2 Mac. & G. 389; Whiteside v. Bellchamber, 22 Upp. Can. (C. P.) 241.

any case where the contract is one which, from the nature and object of incorporation, the corporate body is expressly or impliedly prohibited from making; such a contract is said to be *ultra vires;* and the question here, as in similar cases, is, whether there is anything on the face of the act of incorporation which expressly or impliedly forbids the making of the contract sought to be enforced."[2]

It is also the settled rule that the permanent way and fixed plant of railway companies cannot, without legislative authority, be mortgaged in the ordinary way so as to give the mortgagees the right to enter upon the property, or to interfere with the use and possession of it by the companies chartered to use it; and other corporations having public duties are under the same inability respecting the mortgaging of their permanent property.[3]

§ 2. **Such also may be considered the settled law of the American courts.** The grant of the franchise to be a corporation, with the grant to build and work a railroad and take tolls from the public, is attended with an obligation on the part of the company to exercise the franchise for the public benefit. The franchise and the attendant privileges are confided to a particular political person, and are not a subject of sale and transfer to any other person or body corporate, except by the authority of some positive provision of law.[4] The

[2] Gardner v. London &c. R. Co. L. R. 2 Ch. App. 201, 212. Lord Justice Cairns, upon this subject, said: "When parliament, acting for the public interest, authorizes the construction and maintenance of a railway, both as a highway for the public and as a road on which the company may themselves become carriers of passengers and goods, it confers powers and enforces duties and responsibilities of the largest and most important kind, and confers and imposes them upon the company, which parliament has before it, and upon no other body of persons."

[3] Gardner v. London &c. R. Co. L. R. 2 Ch. App. 201, 212, per Cairns, L. J.; Panama Mail Co., In re, L. R. 5 Ch. App. 318, 321, per Gifford, L. J. Myatt v. St. Helen's &c. R. Co. 2 Q. B. 364; Hart v. Eastern &c. R. Co. 7 Exch. 246.

[4] Troy &c. R. Co. v. Kerr, 17 Barb. (N. Y.) 581; Black v. Del. & R. Canal Co. 22 N. J. Eq. 130, 399; 24 N. J. Eq. 455; Stewart's Appeal, 56 Pa. St. 413; Maryland v. Consolidation Coal Co. 46 Md. 1, 10; Hays v. Ottawa &c. R. Co. 61 Ill. 422; Arthur v. Commercial &c. Bank, 17 Miss. 394, 431, 48 Am. Dec. 719;. McAllister v. Plant, 54 Miss. 106, 119; Singleton v. Southwestern R. Co. 70 Ga. 464, 48 Am. 574n; Branch v. Jesup, 106 U. S. 468, 1 Sup. Ct. 495.

function, however, which is not assignable, is the corporate existence, —the right of being a body politic with rights of succession, of acquiring and conveying property, and of suing and being sued in its corporate name. The right to build, own and manage a railroad, and to take tolls thereon, if given to a natural person, might be assigned by him; for there is nothing in the nature of such a privilege inconsistent with a sale and transfer to another. But a corporation created for a public object can neither transfer its franchise, nor, it would seem, disable itself from performing its public duties, by conveying[5] or leasing[6] its track and right of way, or other property which is essential to its fulfilling the duties imposed upon it by its charter.

In Massachusetts, under the peculiar wording of the statute, gas companies and heating companies are to be regarded as ordinary manufacturing corporations, and not as *quasi*-public corporations, so far as the power to make a mortgage is concerned.[7] But in the absence of statute it has been declared "to be settled by an overwhelming weight of authority that *quasi*-public corporations, which possess or exercise the power of eminent domain, or its equivalent, owe duties to the

[5] Richards v. Merrimack &c. R. Co. 44 N. H. 127, per Bell, C. J.; Gulf C. &c. R. Co. v. Morris, 67 Tex. 692, 4 S. W. 156; Pennsylvania R. Co. v. St. Louis &c. R. Co. 118 U. S. 290, 309, 6 Sup. Ct. 1094; Naglee v. Alexandria &c. R. Co. 83 Va. 707, 3 S. E. 369, 5 Am. St. 308n; Wright v. Milwaukee Elec. R. &c. Co. 95 Wis. 29, 69 N. W. 791, 36 L. R. A. 47, 60 Am. St. 74; State v. Anderson, 97 Wis. 114, 72 N. W. 386; Waldoborough v. Knox &c. R. Co. 84 Me. 469, 24 Atl. 942.

[6] Troy &c. R. Co. v. Boston &c. R. Co. 86 N. Y. 107; Abbott v. Johnstown R. Co. 80 N. Y. 27, 36 Am. R. 572; Marie v. Garrison, 13 Abb. N. C. (N. Y.) 210; Central &c. R. Co. v. Morris, 68 Tex. 49; International &c. R. Co. v. Underwood, 67 Tex. 589, 4 S. W. 216; Thomas v. Railroad Co. 101 U. S. 71; Oregon R. &c. Co. v. Oregonian R. Co. 130 U. S. 1, 9 Sup. Ct. 409; Cox v. Terre Haute &c. R. Co. 123 Fed. 439. In England, Massachusetts, New Jersey, Ohio, and Vermont, a lease by a railroad company of its road and franchise is either impliedly prohibited or wholly unauthorized. In New York, while there is no express legislative authority for such a lease, it is neither *malum in se* nor *malum prohibitum*, nor is it void as contrary to public policy. Woodruff v. Erie R. Co. 93 N. Y. 609. In Indiana a railroad corporation may make a valid lease of its road, it not being in contravention of any statute nor of public policy. Pittsburgh &c. R. Co. v. Columbus &c. R. Co. 8 Biss (U. S.) 456.

[7] Commonwealth v. Lowell Gas Light Co. 94 Mass. 75; Evans v. Boston Heating Co. 157 Mass. 37, 31 N. E. 698.

public as well as to their stockholders, and that they cannot sell or lease their corporate powers and privileges, and thereby disable themselves from performing their public duties without legislative authority."[8]

§ 3. **Whether a railroad corporation can without legislative authority transfer its franchises, by way of mortgage,** is an inquiry to which the same answer must be made, for the same reason, that these privileges are personal to the grantee. Inasmuch as every mortgage may in the end result in an absolute transfer of the mortgaged property, it follows that such a corporation cannot, without special authority, mortgage its property and give to the mortgagee, upon default, the right to exercise its public duties and functions, or the power to sell and convey these privileges to another.[9]

[8] Brunswick Gas L. Co. v. United Gas &c. Co. 85 Me. 532, 27 Atl. 525, 35 Am. St. 385n, per Walton, J.

[9] Carpenter v. Black Hawk &c. Co. 65 N. Y. 43, 50; Pullan v. Cincinnati &c. R. Co. 4 Biss. (U. S.) 35; Susquehanna Canal Co. v. Bonham, 9 W. & S. (Pa.) 27; Pierce v. Emery, 32 N. H. 484; Arthur v. Commercial &c. Bank, 17 Miss. 394, 48 Am. Dec. 719; Atkinson v. Marietta &c. R. Co. 15 Ohio St. 21; Stewart v. Jones, 40 Mo. 140; New Orleans &c. R. Co. v. Harris, 27 Miss. 517; Hall v. Sullivan R. Co. 21 Law R. 138; Daniels v. Hart, 118 Mass. 543; Wood v. Bedford &c. R. Co. 8 Phila. (Pa.) 94; State v. Mexican Gulf R. Co. 3 Rob. (La.) 513.

In a case before the Supreme Court of Massachusetts, Mr. Justice Hoar forcibly states the law: "In the case of a railroad company, created for the express and sole purpose of constructing, owning, and managing a railroad; authorized to take land for this public purpose under the right of eminent domain; whose powers are to be exercised by officers expressly designated by statute; having public duties, the discharge of which is the leading object of its creation; required to make returns to the legislature,—there are certainly great and in our opinion insuperable objections to the doctrine that its franchise can be alienated, and its powers and privileges conferred by its own act upon another person or body, without authority other than that derived from the fact of its own incorporation. The franchise to be a corporation clearly cannot be transferred by any corporate body, of its own will. Such a franchise is not, in its own nature, transmissible. The power to mortgage can only be coextensive with the power to alienate absolutely, because every mortgage may become an absolute conveyance by foreclosure. And although the franchise to exist as a corporation is distinguishable from the franchises to be enjoyed and used by the corporation after its creation; yet the transfer of the latter differs essentially from the mere

Other like corporations are subject to the same inability to make any alienation, absolute or conditional, either of the general franchise to be a corporation, or of the subordinate franchise to manage and carry on the corporate business.[10] Thus, this inability attaches to a corporation created for the purpose of constructing and maintaining a street railway. The main object in establishing such a corporation is not the profit of the shareholders, but the accommodation of the public. A mortgage made by such a corporation of all its property, without distinct legislative authority, is wholly void and inoperative, because it is in violation of the public policy of the state.[11]

§ 4. **Even when organized under a statute providing that the corporation may "acquire and convey, at pleasure,** all such real estate as may be necessary and convenient to carry into effect the object of the incorporation," a railroad company has no power to alienate its franchise to be a corporation, or the franchise to construct and maintain a railroad, and receive compensation for the transportation of persons and property, nor any interest in real estate acquired and held solely and exclusively for the purpose of the exercise of such franchise.[12] The general words of the statute do not extend to an alienation of the franchise, and they must be limited to the purposes for which the statute authorized the formation of corporations. When power is given to acquire an interest in real estate for the single and exclusive purpose of the exercise of a franchise, and particularly when, to acquire such interest, there is a

alienation of ordinary corporate property. The right of a railroad company to continue in being depends upon the performance of its public duties. Having once established its road, if that and its franchise of managing, using, and taking tolls or fares upon the same are alienated, its whole power to perform its most important functions is at an end. A manufacturing company may sell its mill and buy another; but a railroad company cannot make a new railroad at its pleasure." Commonwealth v. Smith, 92 Mass. 448, 455, 87 Am. Dec. 672; and see East Boston Freight &c. R. Co. v. Eastern R. Co. 95 Mass. 422; Richardson v. Sibley, 93 Mass. 65, 87 Am. Dec. 700.

This doctrine is substantially denied in Maine. Shepley v. Atlantic &c. R. Co. 55 Me. 395; Kennebec &c. R. Co. v. Portland &c. R. Co. 59 Me. 9, 23. See § 18.

[10] See § 1, last paragraph.

[11] Richardson v. Sibley, 93 Mass. 65, 87 Am. Dec. 700.

[12] Coe v. Columbus &c. R. Co. 10 Ohio St. 372, 75 Am. Dec. 518n.

delegation of the power of eminent domain, the interest cannot be separated from the use to which alone it can be applied; and if the franchise cannot be conveyed, neither can the interest in real estate with which it is connected be conveyed.[13]

§ 5. Ordinary private corporations for gain, having no public functions, not only have an implied power to incur debts and borrow money for the purposes of the corporation, but also an implied power to pledge either real or personal property as security.[14] Whatever qualifications of this rule, or exceptions to it, may have been recognized by the English courts,[15] in the United States the rule is established without conflict of authority.[16] The power of such corporations

[13] Per Gholson, J., in Coe v. Columbus &c. R. Co. 10 Ohio St. 372, 75 Am. Dec. 518n.

[14] Bank of Australasia v. Breillat, 6 Moo. P. C. 152; Royal British Bank v. Turquand, 6 E. & B. 327; International L. Asso. Soc., In re, L. R. 10 Eq. 312; Birmingham Banking Co., Ex parte, L. R. 6 Ch. App. 83; General Provident Ass. Co., In re, L. R. 14 Eq. 507; General South Am. Co., In re, L. R. 2 Ch. D. 337, 340; Lehman Bros. v. Tallassee Mfg. Co. 64 Ala. 567; West v. Madison Co. Ag. Board, 82 Ill. 205; Wood v. Whelen. 93 Ill. 153; Aurora Agricultural Soc. v. Paddock, 80 Ill. 263; Detroit v. Mut. Gas Light Co. 43 Mich. 594, 5 N. W. 1039; Burt v. Rattle, 31 Ohio St. 116; Hackensack Water Co. v. DeKay, 36 N. J. Eq. 548; Larwell v. Hanover Sav. &c. Soc. 40 Ohio St. 274, 282, per Dickman, J.; Antietam Paper Co. v. Chronicle Publishing Co., 115 N. C. 143, 20 S. E. 366.

Of course the authority of ordinary business corporations to borrow money and secure the same by mortgage of their property may be restricted by legislation. Thus in Alabama a vote of a majority of the stock is required, and the amount of debts cannot exceed two-thirds of the amount of the capital stock, unless the capital stock is all paid, and then such secured debt may be to the extent of the stock. Code 1886, § 1812.

[15] See German Mining Co., In re, 4 De G., M. & G. 19; Lowndes v. Garnett &c. Min. Co. 33 L. J. (Ch.) 418; Norwich Yarn Co., In re, 22 Beav. 143; Troup's Case, 29 Beav. 353.

[16] Curtis v. Leavitt, 15 N. Y. 9; Beers v. Phœnix Glass Co. 14 Barb. (N. Y.) 358; Mead v. Keeler, 24 Barb. (N. Y.) 20; Partridge v. Badger, 25 Barb. (N. Y.) 146; Clark v. Titcomb, 42 Barb. (N. Y.) 122; Barnes v. Ontario Bank, 19 N. Y. 152; Nelson v. Eaton, 26 N. Y. 410; Bradley v. Ballard, 55 Ill. 413, 8 Am. R. 656; Rockwell v. Elkhorn Bank, 13 Wis. 653.

In a recent leading case in England (Patent File Co., In re, L. R. 6 Ch. App. 83, 88), which involved the question whether a file manufacturing company had power to secure an overdraft at its bankers by a

to mortgage, unless expressly prohibited, goes *pari passu* with the power to incur debts.[17]

Corporations not expressly or impliedly restrained by the nature of their undertaking may borrow money to carry out the legitimate objects of their incorporation, and secure the payment of it by a mortgage of their property.[18] Thus, for instance, a corporation organized for the purposes of manufacturing and supplying gas to the inhabitants of a city or village is under no restriction in this respect arising by implication from the nature of the business it was created

deposit of title deeds, Mellish, L. J., affirming the decision of the Vice-Chancellor, that the company had such power, said: "It is urged that no company can mortgage unless expressly authorized to do so. Now the company has property which it is authorized to deal with, and I should say that the true rule is just the contrary, namely, that the company can mortgage, unless expressly prohibited from doing so." And further: "There being nothing in the articles to prohibit the giving of such a security, I am of opinion that the company can give it as well for a past debt as for a future one. In fact the case is stronger in favor of a security for a past debt, as it would be absurd to say that a company has not power to pay past debts; and if so, why should it be debarred from giving security, which is one way of applying its property in payment of its debts?"

In another case, Australian &c. Co. v. Mounsey, 4 K. & J. 733, 27 L. J. (Ch.) 729, it was held that a steamship company, being in want of money for the purposes of the company's business, might mortgage its ships as security for the loan, the Vice-Chancellor, Page Wood, saying: "I cannot see why it should not be within their ordinary province to raise money by mortgage of their ships, either for the purpose of buying new ships or paying creditors."

[17] Bell & Coggeshall Co. v. Kentucky Glass Works Co. 106 Ky. 7, 50 S. W. 2, 1092, 51 S. W. 180.

[18] Curtis v. Leavitt, 15 N. Y. 9; Straus v. Eagle Ins. Co. 5 Ohio St. 59; Monument National Bank v. Globe Works, 101 Mass. 57, 3 Am. R. 322; Hunt v. Memphis Gaslight Co. 95 Tenn. 136, 31 S. W. 1006. In Farmers' Bank v. Ohio &c. Steamboat Co. 108 Ky. 447, 56 S. W. 719, the court, in deciding a steamboat company could execute a mortgage, said: "The common law powers of private trading corporations of this character are ordinarily the same as those possessed by individuals, and may be employed in the same manner, and, unless restricted by their charters or some positive or clearly implied prohibition of law, have the power to mortgage their property to secure the payment of borrowed money or debts necessarily contracted in the course of their business * * *"

to engage in.[19] This restriction upon the right of a corporation to alienate its property arises, not from the fact that it subserves a public use, and is beneficial, or, it may be, necessary to the general public, but it applies only when the state, in view of the public purpose of a corporation, has conferred upon it special privileges, of which the right of eminent domain is generally the most important.

§ 5a. Charitable and religious corporations. In New York the better opinion and the weight of judicial authority is in favor of the view that the English statutes passed in the reign of Elizabeth, restricting religious and charitable corporations from alienating their real estate, have been adopted and followed.[20] The New York act of 1813[21] relative to such corporation was interpreted to forbid sales of land by them without the assent of a court of justice, and the language of the present act is almost identical in terms.[22] Therefore it cannot be doubted that the legislature intended to and did enact that compliance with that statute should be absolutely necessary to the validity of any mortgage of real estate which corporations of the class described therein should execute and deliver. It was assumed that without the statute such corporations could not mortgage their lands at all, and the legislative intent was to permit them to do so only when the assent of the court was first obtained.[23] Under the statute of Idaho, as well, a benevolent corporation cannot encumber its property without an order from the district court.[24]

Under the Minnesota statute,[25] authorizing the organization of corporations for the one purpose "of procuring and holding lands to be used exclusively for a cemetery or place for the burial of the dead," a corporation organized for such purpose is not estopped to deny its

[19] Hays v. Galion Gas Light &c. Co. 29 Ohio St. 330. A general statute authorizing private corporations to execute mortgages has been held to authorize a gas company to mortgage its property franchises. Threadgill v. Pumphrey, 87 Tex. 573, 30 S. W. 356; Pumphrey v. Threadgill, 9 Tex. Civ. App. 184, 28 S. W. 450.

[20] Madison Ave. &c. Church v. Baptist Church, 46 N. Y. 141; De Ruyter v. St. Peter's Church, 3 Barb. Ch. (N. Y.) 122; Bogardus v. Trinity Church, 4 Paige (N. Y.) 178.

[21] Rev. St. (Banks 8th Ed.), p. 1888, § 11.

[22] Act of 1854, ch. 50, § 1.

[23] Dudley v. Congregation, 138 N. Y. 451, 34 N. E. 281.

[24] Portneuf Lodge v. Western &c. Co. 6 Ida. 673, 59 Pac. 362; Rev. St. § 2674.

[25] G. S. 1878, ch. 34, § 239.

power to mortgage its lands dedicated to cemetery purposes. Upon grounds of public policy, for reasons which directly and primarily concern the public, the power of the corporation to convey away or to mortgage the trust property being expressly restricted, the mortgage is absolutely void. As it is wholly beyond the power of the corporation to thus mortgage its cemetery lands, so it cannot validate or give legal effect to its void act by ratification, or by acceptance of benefits thereunder. The doctrine of estoppel is not applicable, as it might be if the corporation were one created for the accomplishment of private, rather than public, purposes, or if the defect consisted only of some irregularity in the exercise of a power.[26]

§ 6. **But the power to transfer corporate privileges and property by way of mortgage is readily conferred by the legislature** upon corporations having special privileges intrusted to them for public uses; or a mortgage made without such authority is usually confirmed by the legislature whenever such confirmation is asked for.[27]

An express power to mortgage would seem to negative any implied power for the same purpose, so that where there is express authority to give securities up to a certain amount, there can be no implied authority beyond this amount.[28] But an express authority to mortgage for certain purposes does not necessarily negative or qualify a general authority to borrow for other purposes for which the implied powers of a corporation are usually sufficient.[29] In general, it may be said that every private corporation has an implied power to borrow

[26] Wolford v. Crystal Lake Cemetery Co. 54 Minn. 440, 56 N. W. 56. It has been held that land dedicated to burial purposes by a cemetery corporation could not be sold on execution. Oakland Cemetery Co. v. People's Cemetery Asso. 93 Tex. 569, 57 S. W. 27, 55 L. R. A. 503.

[27] Richards v. Merrimack &c. R. Co. 44 N. H. 127; Kennebec &c. R. Co. v. Portland &c. R. Co. 54 Me. 173; Pierce v. Milwaukee &c. R. Co. 24 Wis. 551, 1 Am. R. 203; St. Paul &c. R. Co. v. Parcher, 14 Minn. 297. Authority to a railway company to mortgage "a part or the whole of its entire property and franchise" does not empower it to mortgage its income, rents and profits, when that is prohibited by a general statute. Georgia &c. R. Co. v. Barton, 101 Ga. 466, 28 S. E. 842.

[28] Brice Ultra Vires (2d Eng. ed.) 273.

[29] Allen v. Montgomery R. Co. 11 Ala. 437; Mobile &c. R. Co. v. Talman, 15 Ala. 472; Phillips v. Winslow, 57 Ky. 431, 68 Am. Dec. 729.

money and give its negotiable securities therefor, unless it be expressly or impliedly restrained by legislation; and it is only when the corporation attempts to pledge its privileges and property essential to its continued existence and the fulfilment of its duties to the public, that it meets an implied restriction upon its action.[30]

A corporation authorized by its charter or by statute to execute a mortgage is the proper judge whether the exigency of its affairs and interest demand the exercise of this right; and a creditor of the company cannot interfere with the making of such mortgage unless he can show that his rights will be prejudiced by it.[31]

In North Carolina it has been held that the legislature has the power to authorize a board of water commissioners of a city to issue bonds for water-works and execute a mortgage on the plant to secure them.[32]

§ 6a. **A majority of bondholders and stockholders may determine the advisability of exercising a statutory authority** to sell or lease a railway, even though such sale is not made to effect a foreclosure of the mortgage securing the bonds. There being nothing to the contrary in the charter, or in any public statute, or in the by-laws, it is the right of the majority in interest to determine whether the sale or lease shall be made. To allow a small minority to defeat the wishes of the majority would be to ignore the relations which bondholders, secured by a railroad mortgage, bear to each other. But the court will at all times protect a minority of stockholders against a fraudulent, collusive, or oppressive exercise of power by the majority.[33]

§ 7. **The authority to mortgage the franchise need not be given in express terms.** It is sufficient if it appears by a reasonable implication from a special statute that the legislature intended to authorize such a conveyance.[34] But whether a statute referring only to property will authorize a mortgage of franchises may well be questioned.[35]

In a case before the District Court of the United States for Indiana,

[30] See Chapter VII.

[31] Reed v. Bradley, 17 Ill. 321.

[32] Brockenbrough v. Commissioners, 134 N. Car. 1, 46 S. E. 28.

[33] Waldoborough v. Knox &c. R. Co. 84 Me. 469, 24 A. 942.

[34] East Boston &c. R. Co. v. Eastern R. Co. 95 Mass. 422.

[35] Dunham v. Isett, 15 Iowa 284. See Pollard v. Maddox, 28 Ala. 321.

it was questioned whether a railway company whose charter merely authorized it to mortgage its "road, income, and other property," could mortgage its franchises. But whether the company had power to mortgage its franchises or not, it could make a valid mortgage of the road itself, its tolls, income, and real estate.[36]

A railway company authorized by its charter to borrow money, and to execute "such securities, in amount and kind," as it might deem expedient to secure such loans, has been held to be authorized to mortgage its entire road, with its franchises, and all its property, as well all future acquisitions for the use of the road as the property it then had in possession.[37]

A statute of the State of Mississippi authorizing the Southern Railroad Company to buy out and absorb the Vicksburg and Jackson Railroad Company expressly empowered it to use its bonds secured by mortgage of the real and personal property of the road, its "appurtenances and franchise;" and to use such bonds in paying the indebtedness growing out of the purchase of the latter road, or in the construction of the unfinished portion of that road, or in such other way as the company might desire. This was considered as giving ample authority for making a mortgage of its franchise and property.[38]

A railroad company which has the power to sell its property may mortgage it.[39] Thus, a charter conferring the right "to acquire, alien, transfer, and dispose of property of every kind," confers the power to mortgage it. But this is affirmed of the property of the company as distinguished from its franchises.[40] The power to mortgage would, however, generally include the franchises necessary to use and enjoy the property, as distinguished from the franchise to be a corporation.[41] The words "dispose of," used in the act of incorporating

[36] Pullan v. Cincinnati &c. R. Co. 4 Biss. (U. S.) 35.

[37] Pierce v. Milwaukee &c. R. Co. 24 Wis. 551, 1 Am. R. 203.

[38] McAllister v. Plant, 54 Miss. 106.

[39] Willamette Mfg. Co. v. Bank of British Columbia, 119 U. S. 191, 7 S. Ct. 187.

[40] McAllister v. Plant, 54 Miss. 106; Branch v. Atlantic &c. R. Co. 3 Woods (U. S.) 481. Under a statute authorizing corporations to borrow money, execute bonds and notes therefor and pledge their property and income, a water company was allowed to mortgage its franchise to pipe water through city streets, conferred by a city ordinance. It had a property right under the ordinance mentioned. State v. Topeka Water Co. 61 Kan. 547, 60 P. 337.

[41] Branch v. Atlantic &c. R. Co. 3 Woods (U. S.) 481; Wayne v. Myddleton, 2 Kelly (Ga.) 383.

the Union Pacific Railroad Company, in reference to lands granted to the company, are apt words to indicate a transfer by mortgage. They contemplate a use of the lands granted different from the sale of them.[42]

Upon a valid consolidation of existing railroad companies into a new corporation, having the rights and powers of the old corporations, the new corporation succeeds to the powers which the old companies had to issue bonds and to mortgage its property for their security, including the power to issue secured bonds in exchange for the bonds issued by the old companies.[43]

§ 8. Legislative authority to mortgage may apply to the property of a corporation and not to its franchises. If a corporation, having power by its charter to pledge its real estate or its property and profits, executes a mortgage covering not only these, but also its franchise to be a corporation, such mortgage is not for that reason entirely void, but it operates to convey the property of the company.[44] A mortgage, however, of "all the present and future to be acquired property of the company, and all its estate and franchises," followed by an enumeration of the property and rights intended to be conveyed, may be so limited and explained by such enumeration as to be brought within the limits of such legislative authority.[45]

A mortgage may be valid in part and in part void. Thus, if a corporation mortgages its property and franchises when it has no power to transfer its franchises, but is not restrained by law in respect to transfers of its property, the mortgage may effectually pass the property, while it is ineffectual to transfer its franchises.[46] Under a statute providing that corporations for manufacturing, mining, mechanical, or chemical purposes shall not mortgage any property except real estate, and shall not do this except to secure the payment of debts, a mortgage by such corporation to secure bonds is valid so far as the bonds are used for the payment of its debts, even though invalid so far as the bonds are used to raise money to carry on its operations.[47]

[42] Platt v. Union Pac. R. Co. 99 U. S. 48.

[43] Mead v. New York &c. R. Co. 45 Conn. 199.

[44] Randolph v. W. &c. R. Co. 11 Phila. (Pa.) 502.

[45] Butler v. Rahm, 46 Md. 541.

[46] Carpenter v. Black Hawk &c. Min. Co. 65 N. Y. 43; Central &c. Min. Co. v. Platt, 3 Daly (N. Y.) 263.

[47] Carpenter v. Black Hawk &c. Min. Co. 65 N. Y. 43.

It is doubtless true that the bonds not used for this purpose would be valid in the hands of *bona fide* holders; and that as against such holders the company would be estopped from claiming the invalidity of the mortgage.

§ 9. The scope and purpose of the power conferred must be substantially met in its exercise. Under a statute authorizing any railroad corporation to borrow money "for completing, furnishing and operating its road," and to issue bonds therefor, secured by a mortgage of its property and franchise,[48] a mortgage which appeared upon its face to be "made to consolidate its funded debt, obtain the money and material necessary for perfecting its line of railway, enlarging its capacities, and extending the facilities thereof," is within the scope of the powers conferred. Without other proof of the object of the mortgage, no suit to restrain the making of it, or the issuing of bonds under it, can be maintained by a common stockholder, or by a preferred stockholder of the corporation. For aught that appears in the case, the funded debt and other debts may have been incurred in constructing and operating the road, and the excess of money sought to be obtained by such bonds may be necessary further to complete and operate the same.[49] If the power to make such mortgage exists, a common stockholder cannot restrain the making of it: and a preferred stockholder stands in no better condition, because, if his right to receive interest is subject to the payment of the interest on all the mortgages of the company, whether made before or after the issuing of the stock, he could not object to the making of a new mortgage for a new indebtedness; and certainly he could not object to a mortgage which consolidated the funded debts of the company, or which embraced subsequent indebtedness with such debts. If, on the other hand, the preferred stockholder be entitled to interest on his preferred stock, subject only to the payment of interest on the mortgages then existing, his rights would remain unaffected by the issuing of subsequent mortgages.

Under an authority given by charter or by statute to borrow money, a corporation has no right to raise money by the issue of irredeema-

[48] 2 R. S. N. Y. 1875, p. 532; Pt. I. ch. 18, tit. 15, § 39; Laws 1850, ch. 140, § 28.

[49] Thompson v. Erie R. Co. 42 How. Pr. (N. Y.) 68, 11 Abb. Pr. N. S. 188.

ble bonds entitling the holder merely to a share of the earnings after the payment of certain dividends to the stockholders. Money so obtained could not be regarded as borrowed, because that term implies reimbursement.[50]

It has been suggested that a mortgage of a railway and its franchise, made without legislative authority, is not wholly void and inoperative, but that a court of equity may give effect to such an instrument, at least to the extent of treating it as a good equitable charge upon the net earnings of the railroad.[51]

§ 10. Authority to mortgage for the purpose of constructing a railroad confers no right to secure by mortgage the debt of another. A railroad company having authority to borrow such sums of money as might be expedient for completing, maintaining, and working the railway, and to make bonds, debentures, or other securities, and sell the same, and to hypothecate, mortgage, or pledge the lands, tolls, revenues, and other property of the comnay, for the due payment of such sums and the interest thereon,[52] cannot make a mortgage for any purpose not embraced in the terms of the act, and therefore cannot make a mortgage to secure a debt which is not a debt of the company. When the express purpose for which a mortgage is authorized to be given is the repayment of a loan of money for the completion or maintenance of the road, a mortgage to secure the debt of another, though it may be for the benefit of the company to make it, is *ultra vires* and void.[53]

Although there may be no substantial divergence of opinion in relation to the correctness of these general principles, a wide difference will be noticed in the application of them by different courts rendering judgments in the cases cited.[54]

[50] Taylor v. Philadelphia &c. R. Co. 7 Fed. 386.

[51] Bickford v. Grand Junction R. Co. 1 Can. S. C. 696, 737, per Strong, J. See § 18.

[52] Railway Act of Ontario, sec. 9, sub-sec. 11.

[53] Grand Junction R. Co. v. Bickford, 23 Grant's Ch. (Ont.) 302.

[54] The Grand Junction Railway Company, having such authority to mortgage its property, entered into an agreement with a contractor for building its road, by which the contractor was to receive in payment certain municipal and other securities, and the balance in the first mortgage bonds of the company, upon the completion of the work. After building a portion of the road, the contractor was unable to procure iron for it, and the railway

§ 11. A mortgage made without legislative authority of corporate property essential to the exercise of the corporate franchise would

company, to unable him to obtain it, made a mortgage of a portion of its road to secure the notes of the contractor given for the price of the iron, with the provision that, in case of his failure to pay the notes, the mortgagee's sole recourse should be against the property, and not against the company. The vendors of the iron retained a lien upon it until it should be laid on the track. The contractor, after laying a small part of the iron, became insolvent, and a large quantity of iron which had been delivered to him, but which had not been laid upon the road, was sold by the vendors at a large loss from the price at which the iron was purchased. The holders of the mortgage of the railway then sought to enforce it for the value of the iron actually laid upon the track, as well as for the loss resulting from the resale of the iron. The railway company, while not objecting to paying the price of the iron actually placed upon the road, objected to paying the loss arising from the resale; and contended that the mortgage was *ultra vires*, and it was so held by the Court of Appeals of Ontario. Grand Junction R. Co. v. Bickford, 23 Grant's Ch. (Ont.) 302. On appeal the Supreme Court of Canada (Bickford v. Grand Junction R. Co. 1 Can. S. C. 696, 733) reversed this judgment, and held the mortgage valid. The court start with the proposition that every corporation has the power to mortgage its property, unless this power be limited by its charter or by statute; although such limitation may be deduced either from the object of the corporation being limited to certain specific things, or from its property being subject to charges or trusts in favor of the public, with which a mortgage would be inconsistent. The statutes, however, confer express power to mortgage the company's property for the payment of loans and debentures. This statutory power to mortgage does not restrict the general power of the company incidental to its existence to deal with its property by way of mortgage. The mortgage, moreover, was within the scope of the powers conferred upon the company to construct and work a railway. The iron rails, for the price of which the mortgage was given, were indispensable to enable the company to carry out its undertaking. The company might have purchased them directly from the vendors. It was found more convenient, however, to make a contract for the construction of the railway, by which the contractor undertook to furnish the iron. Having the power to give a mortgage to secure the price of rails, it can make no difference that they have given the mortgage as sureties for the contractor, and not as direct purchasers. Indirectly, it is given to secure the price of rails. "Had the mortgage been given for any object foreign to, or inconsistent with, the purposes of the incorporation, then, no doubt, it would have been *ultra vires* of the company. A familiar instance of a railway company exceeding the limits of its un-

seem, on principle, to be subject to the same objection that is made to a mortgage of the corporate franchise itself without such authority.[55] The adjudications upon this point are conflicting, though their weight is in favor of the proposition stated.

A mortgage made in pursuance of authority to borrow money on the credit of the undertaking, and to "assign and charge the property of the undertaking, and the rates and tolls, as a security for the money" borrowed, was held not to include the land of the company. The mortgage followed the words of the power given to the company to raise money, assigning "the said undertaking, and all and singular the rates, tolls," etc. Lord Denman, C. J., in his decision, said:[56] "In my opinion there is nothing in those words to justify the construction that they contain a demise of the land, or of any portion of the real estate of the defendants. Such a demise would not only be exceedingly improbable, but very inconvenient to the public, as it would perchance prevent the carrying on of the very 'undertaking' by means of which the defendants were to be enabled to satisfy the demands of their creditors and to promote the convenience of the public."[57]

§ 12. But land of a railway company not acquired under the delegated right of eminent domain, or so connected with the franchise to operate and manage a railroad that the alienation would tend to disable the corporation from performing the public duties imposed upon it, and in consideration of which its chartered privileges had been

dertaking is afforded by a well-known case, in which such a corporation added to its legitimate business that of a line of steamships. Had this mortgage been given in aid or furtherance of any similarly unauthorized enterprise, it would, of course, have been *ultra vires;* but it is manifest that such was not the case here, and that the sole object of the corporation was to attain the end for which it had been created." Of this judgment of the Supreme Court of Canada it may be remarked that, conceding its correctness as applied to the case in hand, it contains some general propositions and reasoning not in accordance with the best English and American authorities.

[55] Grand Junction R. Co. v. Bickford, 23 Grant's Ch. (Ont.) 302.

[56] Myatt v. St. Helen's &c. R. Co. 2 Q. B. 364.

[57] See, however, to the contrary, § 18; White Water &c. Co. v. Vallette, 62 U. S. 414, per Campbell, J.; and see Shepley v. Atlantic &c. R. Co. 55 Me. 395; Kennebec &c. R. Co. v. Portland &c. R. Co. 59 Me. 9, 23.

conferred, may be conveyed or mortgaged by the company without special authority, under the general right of corporations at common law to dispose of whatever property they have power to acquire.[58] If the company should include in one deed or mortgage both real estate not connected with its franchises and real estate essential to the exercise and enjoyment of its franchises, as, for instance, a portion of its roadway, the conveyance might be upheld as to the former, and treated as inoperative and void as to the latter. The ordinary rule is applied that, if the part of the subject of the conveyance which is valid can be separated from that which is void, the conveyance will be carried into effect so far as it can be. As to property not acquired for the purposes of the road, the corporation stands in the relation of an ordinary trading corporation which has no public obligations.

The power of mortgaging land grants or surplus lands not needed for the permanent way, station-houses, or grounds required for the uses or purposes of the railroad, is one of the ordinary powers of a railroad company. This right of alienation extends to lands acquired in the exercise of compulsory powers as well as those obtained by purchase and government grant. It is a matter of common experience that upon the completion of a railroad the company finds itself in possession of land not required for the purpose of its working, which it may have been compelled to purchase as part of other property, or which, purchased or taken as necessary for the use of the railroad, has in the event been found to be superfluous. There is no ground for contending that such land is impressed with a public trust, so that the company cannot freely alienate it.[59] The retention of such lands can serve no possible purpose of public utility or public policy.

A power to mortgage conferred by statute upon a railroad company has reference only to such lands and property as the company could lawfully acquire, and cannot therefore include such as is not necessary to the purposes of the road. But a railroad corporation having authority to receive land in payment of subscriptions for stock, provided that so much of the land as may not be necessary for the use of the road shall be sold within a reasonable time, may mort-

[58] Hendee v. Pinkerton, 96 Mass. 381; Farnsworth v. Minnesota &c. R. Co. 92 U. S. 49; Tucker v. Ferguson, 89 U. S. 527, 572.

[59] Bickford v. Grand Junction R. Co. 1 Can. S. C. 696, 735.

gage such land, if the property be not thereby placed in such condition as to put it out of the power of the company to comply with the terms of the statute.[60]

§ 13. **Authority to a railway company to mortgage its road is authority for its making a mortgage of a part of it.**[61] But if the authority to execute a mortgage of a railroad indicates that the mortgage is to embrace the road as a whole, then it cannot be mortgaged in parts. Thus, a statute of the Province of Ontario, authorizing railway companies to hypothecate, mortgage, or pledge the lands, tolls, revenues, and other property, for the purpose of completing, maintaining, and working their roads, was thought to prohibit by implication the creation of a mortgage upon a part of the line only.[62] A mortgage of an undertaking, or of the property of a railway company as a going concern, is a very different thing from a mortgage of a part of the specific property of a company, and confers very different rights. Notwithstanding the giving of such a mortgage, the interest of the public in the working and maintenance of the road is provided for, because the property cannot be sold under foreclosure, and it is only by keeping the road in a condition to earn surplus revenue that the mortgagee can obtain any benefit from the security.[63]

§ 14. **A mortgage of its property and franchise, executed by a railroad corporation without previous legislative authority, is capable of being ratified and affirmed by the legislature,** and rendered as valid and effectual as it would have been if executed under such previous authority.[64] Such a mortgage is not absolutely void, but voidable only. An act authorizing the trustees under such a mortgage to sell the road is such a ratification.[65] The legislature in ratifying a transfer waives the rights of the public, but does not impair or affect the rights of the stockholders.[66]

[60] Taber v. Cincinnati &c. R. Co. 15 Ind. 459.

[61] Pullan v. Cincinnati &c. R. Co. 4 Biss. (U. S.) 35, 45.

[62] Grand Junction R. Co. v. Bickford, 23 Grant's Ch. (Ont.) 302, 354.

[63] See §§ 65-69.

[64] Shaw v. Norfolk County R. Co. 71 Mass. 162; Richards v. Merrimack &c. R. Co. 44 N. H. 127; Shepley v. Atlantic &c. R. Co. 55 Me. 395; White Water &c. Co. v. Vallette, 62 U. S. 414.

[65] Richards v. Merrimack &c. R. Co. 44 N. H. 127.

[66] Knoxville v. Knoxville &c. R. Co. 22 Fed. 758.

Prior to the enactment of general laws authorizing mortgages by railroad companies, they were frequently made without legislative sanction, in reliance that the legislature would afterwards confirm them; and there seems to have been no difficulty in obtaining such confirmation.

§ 15. **The franchise which a railroad company transfers by its mortgage is not its franchise to exist as a corporation,** but only such of its franchises or privileges as will enable the grantee to have the same use and beneficial enjoyment of the property which the company itself had; and especially is this the case when the charter merely authorizes the company to mortgage "its means, property, and effects," without express mention of franchises.[67] A railroad company's fran-

[67] Mr. Justice Manning, in a recent case before the Supreme Court of Alabama, Meyer v. Johnston, 53 Ala. 237, 325, upon this point said: "Strictly, 'the franchise to exist as a corporation,' is not a corporate franchise, or 'franchise of the corporation,' at all. It is a franchise of the individual corporators, of the natural persons who are shareholders of the capital stock, and pertains to them as such corporators; whereby they are endowed with the privilege and capacity of being constituted into, and coöperating together as a body politic, with power of succession, and without individual liability. And the corporation as such, in its collective capacity or by its board of directors, has no more power to sell this franchise thus pertaining to the corporators individually than it has to sell their paid-up shares of the capital stock. The interest of each of these in this franchise is transferred with his shares of stock, and passes with them from one individual to another; and this is the proper mode of parting with and acquiring this particular privilege. A railroad company may continue to exist as a corporation after its railroad, with all its appurtenances, has been sold away from it. There may be other property to dispose of, or credits to get in, or obligations to be discharged, or interests to be protected, which require its continued existence, and which may not belong to, or be chargeable upon, the persons who were purchasers of its railroad and the franchises necessary for the maintenance and operation of it. And on the other hand, those purchasers might not desire to be constituted into a corporation at all. Or, if they did, it might be very inconvenient to find themselves composing the same body politic whose property had just been sold to them for the payment of some of its debts. For it would seem that if with the railroad they acquired also the company's 'franchise to be a corporation,' with the same faculties and name, by virtue of and with which the former body existed, they acquired it to be assumed and used,

chise to be a corporation is entirely distinct from its franchise to construct and operate its road and is not the subject of sale or transfer unless by virtue of some positive statutory authority.[68]

The mortgage of a railroad, or a sale under the mortgage, does not necessarily work the dissolution of the corporation. It may be ground of forfeiture if insisted upon by the state, but this is a matter between the state and the corporation with which third persons have nothing to do.[69]

A corporation having authority to borrow money, and secure the payment of it by mortgage of "the entire road, fixtures, and equipments, with all the appurtenances, income, and resources thereof," cannot mortgage the franchise to be a corporation appertaining to the individual members of the corporation, but can mortgage the franchise to maintain the railroad and secure compensation for the transportation of persons and property, and can mortgage property connected with the railroad, whether real or personal, then owned by it, or subsequently to be acquired, and the use of its franchise.[70]

§ 16. The franchise to be a corporation is not necessarily included, if it ever be included, in a mortgage by a railroad company of its road and franchises. The right to build, own, manage, and run a railroad, or take the tolls thereon, is not of necessity of a corporate character, or dependent upon corporate rights.[71] It may belong to,

and so must themselves become that corporation, and be bound to perform its obligations." See, however, Pierce v. Emery, 32 N. H. 484. The franchise of a water company to pipe water through streets is a property right protected by the federal constitution. Farmers' &c. Co. v. Meriden Waterworks Co. 139 Fed. 658.

[68] Pennison v. Chicago &c. R. Co. 93 Wis. 344, 67 N. W. 702.

[69] Arthur v. Commercial &c. Bank, 17 Miss. 394.

[70] Coe v. Columbus &c. R. Co. 10 Ohio St. 372, 75 Am. Dec. 518n.

[71] Bank of Middlebury v. Edgerton, 30 Vt. 182, 190; Miller v. Rutland &c. R. Co. 36 Vt. 452, 498.

"To the suggestion that the assignees can obtain and enjoy the fruits of this mortgage only in virtue of the continued existence and organization of the corporation, and the corporation, having parted with rights that are indispensable to its fulfilling the ends for which it was created, would no longer be entitled to continue, and so the end for which it was created would be defeated, it seems sufficient to say, that whether its potential existence and its organization would continue or not would depend on whether it

and be enjoyed by, natural persons, and there is nothing in its nature inconsistent with its being assignable.

The Vermont Central Railroad Company conveyed in trust and mortgage to trustees, to secure the payment of its bonds, its railroad and franchise, "with all the lands thereto belonging and intended for the use and accommodation of said road." Subsequently a creditor recovered judgment against the company, and levied his execution upon certain lands which were not then used for the accommodation of the road; but the trustees claiming the land under the mortgage, a bill in equity was brought to remove such claim, and relieve the title from this cloud. It was held[72] that only such land passed by this

should have subjected itself to a forfeiture of existence by the failure to answer the purposes for which it was created, in the matter of its duties to the public. So long as these duties should be performed, would not the claim of the public, as well as of individuals, be fully answered? And is it to be presumed in anticipation, that the assignees will fail to perform those duties as fully as the corporation would have done, when the same motives exist and would be operative upon the assignees as upon the corporation, and when the same remedies may be made available, both in favor of the public and of individuals, for a failure to operate the road,—namely, as to the public, a forfeiture of the rights granted by the charter, and in favor of individuals, a reverter of the land constituting the roadway?" Per Barrett, J.

[72] Eldridge v. Smith, 34 Vt. 484, 489.

To the argument of counsel, that the mortgage being of the franchise of the corporation, and therefore that all property owned by it, whether connected with the road or not, and whether covered by the language of the description or not, passed by the deed, Chief Justice Poland, delivering the opinion of the court, replied: "It is said that one of the franchises of all corporations is the power of being a body politic, corporate existence, with rights of succession of members. Another is, its rights of representation in court by its corporate name, either as plaintiff or defendant. It has a general power, also, of acquiring, holding, and conveying property. In addition to these general corporate powers, this company was invested by the legislature with a power to build a railroad between certain points, and to operate and manage the same, and take tolls and fares on the same for their own benefit and profit; and, to the extent of the proper necessities of the road, was authorized to exercise the sovereign power of the state, to sequester private property without the consent of the owners, by making compensation therefor. When a railroad company mortgages its road and appurtenances as a security for debt, and also its franchise, it is not to be understood as convey-

conveyance as was so connected with the railroad, and used for it by the company, that it would have been authorized to take the land compulsorily under its charter; although, if so connected and used, it was immaterial whether it was actually so taken or purchased by the company.

In like manner a foreclosure sale of the property and franchises of a railroad company does not pass to the purchaser debts due the company. The corporate existence of the company is continued for the purpose of collecting such debts, as well as for other purposes.[73]

§ 17. **A less stringent doctrine as to the power of a corporation without legislative authority to mortgage its franchise and property** prevails in some states. Thus, in Kentucky it has been held that a railroad company, authorized by its charter to borrow on its credit, but not expressly authorized to make a mortgage of its property or franchises to secure the loan, yet had an implied power to do so; and that although it could not in such case mortgage its corporate existence, or any prerogative franchise conferred upon it, it might mortgage its right to build and use its road, for this is not a prerogative franchise.[74] Upon the foreclosure of such mortgage, a purchaser would take the road subject to the terms of the charter; but he would have power to hold and manage the road as an individual. Whether the road should be operated by an individual or a corporation was not regarded as a matter of any interest to the public; and it was urged that under the charter of a corporation a single person, by purchasing all its stock, could control the road as completely as if he owned it individually.

§ 18. **There are some cases, however, which hold that a corporation may without legislative consent mortgage its lands and other property in the course of its legitimate business,** as it may deem it expedient; and that a railroad corporation, unless restrained by statute,

ing its corporate existence, or its general corporate powers, but only the franchise necessary to make the conveyance productive and beneficial to the grantees, to maintain and support, manage and operate, the railroad, and receive the tolls and profits thereof for their own benefit."

[73] Smith v. Gower, 2 Duv. (Ky.) 17; Williard v. Spartanburg &c. R. Co. 124 Fed. 796.

[74] Bardstown &c. R. Co. v. Metcalfe, 61 Ky. 199, 81 Am. Dec. 541.

has the implied power to borrow money to construct its road, or for other legitimate uses, and to mortgage its property to secure such debts.[75]

It is argued that the change which takes place in a corporation through the foreclosure of a mortgage is no greater than that which may take place within the original corporation by a transfer of shares, and that the public interests are as safe in such new hands as they were in those of the original corporators.[76]

Upon the foreclosure of a mortgage on the property and franchises of a railroad, the trustees under the mortgage purchased the property for the benefit of the bondholders. A new corporation was organized, which made a new mortgage and issued bonds. It was held that the mortgage, though made without legislative authority, was valid.[77]

The argument that it is dangerous to the public interests to have the privileges conferred by a railroad franchise transferred to a new body by the action of the corporation itself, is declared to be of little weight, inasmuch as the active management of the corporation is liable to be changed at any time by the action of the stockholders; and that in all cases the influence of the original corporators is but a temporary matter.[78] Tht privileges conferred upon them soon pass, in the ordinary course of things, to others. By a foreclosure the change of control may be no more complete; and there is no reason to suppose that the purchasers will manage the property with any less regard to public interests.

The supreme court of Vermont regarded the idea as altogether

[75] Savannah &c. R. Co. v. Lancaster, 62 Ala. 555; Kelly v. Alabama &c. R. Co. 58 Ala. 489; Miller v. Rutland &c. R. Co. 36 Vt. 452, 492; Memphis &c. R. Co. v. Dow, 22 Blatchf. (U. S.) 48.

[76] Shepley v. Atlantic &c. R. Co. 55 Me. 395; Memphis &c. R. Co. v. Dow, 22 Blatchf. (U. S.) 48.

[77] Memphis &c. R. Co. v. Dow, 22 Blatchf. (U. S.) 48, 19 Fed. 388, 392. "Here the mortgage was executed to enable the corporation to resume the exercise of its charter powers, and fulfil the purposes for which it was originally created. No precedent has been found denying to a corporation the power to execute a mortgage of everything it acquires by a purchase, when the mortgage is a condition of making the purchase; and there seems to be no reason, in a case like the present, for denying the power, when the purchase of the mortgagor includes the franchise and the whole property of the corporation." Per Wallace, J.

[78] Shepley v. Atlantic &c. R. Co. 55 Me. 395, 407, per Walton, J.; Kennebec &c. R. Co. v. Portland &c. R. Co. 59 Me. 9, 23.

fanciful and theoretical, that, because the franchise is conferred upon a particular body of men constituting the corporation, a special confidence in them to answer the trusts in behalf of the public is implied; declaring that, from the nature of the case, there could not be—for the reason that it lies with the shareholders of the capital stock to say who shall compose the corporation at any given time—one set of men to-day, another to-morrow, some citizens of the state, some foreigners; that the true idea is, that the public relies, for its assurance that its rights will be duly protected, upon the fact that they *must* be, in order that the conferred privileges may be held and enjoyed by the corporation, of whomsoever composed,—not upon any personal confidence which the legislature has in an indiscriminate body of persons (men, women, and children, citizens and foreigners), daily changing, who may become or cease to be stockholders at their own pleasure and without restraint.[79]

Mr. Justice Strong, of the supreme court of Canada, considered it an open question whether all the rights and privileges of a railroad corporation, save only its right to be a corporation, are not susceptible of alienation by mortgage or otherwise; whether it may not, for instance, mortgage or otherwise alienate its rights of taking lands, operating the road, taking tolls, and exercising the other rights and powers usually conferred on railroad companies, the transferees being subject to all the trusts and burdens in favor of the public which the original company was liable to.[80]

§ 19. **Aside from mortgaging their franchises or property, corporations, like individuals, unless restrained by law, have the power to borrow money** and to acknowledge the indebtedness by giving therefor ordinary commercial obligations.[81] If the manner of borrowing

[79] Miller v. Rutland &c. R. Co. 36 Vt. 452, 492, per Barret, J.

[80] Bickford v. Grand Junction R. Co. 1 Can. S. C. 696, 738; citing Hall v. Sullivan R. Co. 21 Law R. 138, per Curtis, J.; Wilmington R. Co. v. Reid, 80 U. S. 264, 268.

[81] See **Chapter III**; West Cornwall R. Co. v. Mowatt, 12 Jur. 407; Australian &c. Co. v. Mounsey, 4 K. & J. 733; Bryon v. Metropolitan &c. Co. 3 De G. & J. 123; Imperial Land Co., In re, L. R. 11 Eq. 478; Kelly v. Alabama &c. R. Co. 58 Ala. 489; Savannah &c. R. Co. v. Lancaster, 62 Ala. 555; Union Mining Co. v. Bank, 2 Colo. 248; Wood v. Whelen, 93 Ill. 153; McCormick v. Stockton &c. R. Co. 130 Cal. 100, 62 P. 267.

be prescribed by statute, or the amount of loans be limited, or the obligations to be given for the money be specified, the implied power is to this extent controlled.

A railroad corporation having power to build a road, and issue bonds and negotiate them to raise money, has authority to issue to contractors, in payment for work done, negotiable certificates of indebtedness payable in money or bonds. The payment of the expense of construction in bonds is a sale of them. Having contracted a legitimate liability, the corporation has undoubted authority to acknowledge it, and to promise to pay it by a written obligation.

On such a certificate, promising to pay a specified sum with interest, in bonds on demand, if the corporation does not on demand exercise its election to make payment in bonds, the creditor may recover the amount in money, payment in bonds being a privilege for the benefit of the corporation; but if this privilege be not taken advantage of at the proper time, the rule of damages is the principal sum and interest.[82] Unless prohibited by statute, a corporation has the same right as an individual to execute a mortgage to secure the payment of money to be thereafter advanced.[83]

§ 19a. Hence legislative authority to mortgage carries with it by implication the power to borrow money and issue bonds therefor. It cannot be contended that, in addition to the power to mortgage, there must also be expressed a specific authority to borrow. The manifest purpose of a mortgage is to secure loans of money, and the power to borrow money and to give the ordinary evidences of loans in the form of bonds, or other obligations to the same effect, is a necessary incident to the power to mortgage. But it is also a necessary incident to the right to build a railroad; and it is only necessary to have the power to mortgage expressly granted, in order that it may be exercised for the purpose of securing indebtedness, whether arising from loans of money or upon other consideration.[84]

§ 20. Where corporations constituted for specific purposes are by statute limited in the amount of money they are permitted to borrow,

[82] Pusey v. New Jersey &c. R. Co. 14 Abb. Pr. N. S. (N. Y.) 434.

[83] Jones v. Guaranty &c. Co. 101 U. S. 622.

[84] Gloninger v. Pittsburg &c. R. Co. 139 Pa. St. 13, 21 Atl. 211.

or conditions are imposed upon them as to the manner in which they shall exercise their borrowing powers, if they borrow in amounts or in a manner unauthorized by law, such loans have no legal validity. Thus where a dock company was authorized by the special act to raise money on the security of the tolls and other property, and the mortgages were directed to be registered, and the company mortgaged to a contractor a quantity of tools, machinery, and materials used on the works, but the securities were not made in the form required by the act, or registered, it was held that the mortgage was void.[85] A restriction as to the amount a corporation may borrow, when it has no power to borrow other than that expressly conferred, as is the case with municipal corporations, would seem to be a condition a breach of which would render the securities void;[86] but if the corporation has a general power to borrow, even if there is no right of action upon securities in excess of the limit, the money lent may be recovered in assumpsit.[87] It may happen also that, while a mortgage given by a corporation may be outside its power, the indebtedness incurred may be a valid obligation.[88] On the other hand, the mortgage may be valid, being expressly authorized, while the acknowledgments of indebtedness secured, as for instance bills of exchange, may be prohibited, in which case the mortgage would be regarded as securing the debt for which the bills of exchange were given, and therefore not on that account invalid.[89] When corporations are restricted in their borrowing to certain amounts, there is no doubt that when this is the case the power may be exercised again and again, so long as the limit is not exceeded at any one time.[90]

The rights of *bona fide* holders of negotiable securities of corporations will be considered elsewhere, as also the circumstances under which corporations may be estopped from taking advantage of an irregular exercise of their borrowing powers; and reference is here made to these subjects merely to say that the rights of holders of securities issued in violation of restrictions imposed by statute may

[85] M'Cormick v. Parry, 7 Exch. 355; 21 L. J. (Ex.) 143.

[86] Gordon v. Sea Fire &c. Asso. 1 H. & N. 599.

[87] Brice Ultra Vires (2d ed.) 267; Pooley Hall Colliery Co., In re, 21 L. T. N. S. 690. For construction of statute limiting amount of bond issue see First Nat. Bank v. Terminal R. Co. 69 Fed. 441.

[88] Holdsworth v. Dartmouth, 11 A. & E. 490.

[89] Scott v. Colburn, 26 Beav. 276.

[90] Brice Ultra Vires (2d ed.) 266.

be secure, although the securities themselves were upon their first issue void.

§ 21. **What are known in England as Lloyd's bonds** are obligations which purport to be issued by corporations for work done, or materials supplied for the purpose of the undertaking. They are generally issued in this way in order to avoid the limitation imposed by parliament as to the amount of money which a railway company is permitted to borrow. As such bonds are nothing more than an acknowledgment under seal of a debt due for a *bona fide* consideration, there is no reason to doubt their validity when given *bona fide* to contractors or others for work actually done.[91] The power to issue such bonds is liable to gross abuse;[92] and when not in fact issued for the purposes specified, they are void.[93] But the substance of the contract, rather than the form of it, is regarded. Thus, where a railway company, whose borrowing powers were not to arise until it had completed and opened a certain portion of its line for traffic, borrowed from another railway company money sufficient to enable it to complete the requisite portion of the line, under an agreement that the borrowing company would, when its borrowing powers arose, issue its debentures in repayment, it was held that there was nothing illegal in the contract, and that the debentures were valid to the extent of the sum actually advanced in payment of the contractor's accounts.[94]

In one respect Lloyd's bonds have an advantage over ordinary mortgages and bonds, for they are not hampered by the provisions of law applicable to securities regularly issued, which place all such obligations upon an equality whenever issued. The holders of these irregular bonds can sue upon them and recover judgment, and issue execution against the corporation, in the same manner as creditors may do upon ordinary debts.[95]

§ 22. **A corporation may borrow from a director, and mortgage its propery to him** to secure the payment of the loan, and the transac-

[91] White v. Carmarthen &c. R. Co. 1 H. & M. 786, 33 L. J. Ch. 93, 1 Cox Joint Stock Cas. 112.

[92] Hodges Law of Railw. (6th ed.) 130.

[93] Chambers v. Manchester &c. R. Co. 5 B. & S. 588, 33 L. J. (Q. B.) 268; Fountaine v. Carmarthen R. Co. L. R. 5 Eq. 316, 37 L. J. Ch. 429.

[94] See Bagnalstown v. Wexford R. Co. L. R. 4 Ir. Eq. 505.

[95] Cork & Youghal R. Co., In re, L. R. 4 Ch. App. 748.

tion, when open, and otherwise free from blame, cannot be impeached.[96] There are three parties whose interests are affected by the transaction; namely, the lender, the corporation, and its stockholders. The directors represent the interests of the corporation and of the stockholders. Therefore, when a director deals with his company, his obligation to candor and fair dealing is increased in the precise degree that his representative character has given him power and control, through the confidence reposed in him by the stockholders who appointed him their agent. This obligation would be still stronger with a sole director, or with one of a very small number vested with the management of the company, and his acts would be subject to more severe scrutiny, and their validity determined by more rigid principles of morality, and by their freedom from ingredients of selfishness. But at the same time a director is more than any one else interested in aiding the corporation judiciously, and is best qualified to judge of the necessity of that aid, and of the extent to which it may be safely given. A loan, therefore, honestly made by a director for the benefit of the corporation, both in the rate of interest and in the

[96] Twin-Lick Oil Co. v. Marbury, 91 U. S. 587; Hotel Co. v. Wade, 97 U. S. 13; Bassett v. Monte Christo &c. Co. 15 Nev. 293; McMurtry v. Montgomery &c. Co. 86 Ky. 206, 5 S. W. 570; Duncomb v. New York &c. R. Co. 84 N. Y. 190, 88 N. Y. 1; Traders' Nat. Bank v. Manufacturing Co. 100 N. Car. 345, 5 S. E. 81; Bradly v. Marine &c. Co. 3 Hughes (U. S.) 26; Schnittger v. Old Home &c. Min. Co. 144 Cal. 603, 78 P. 9; Beach v. Miller, 130 Ill. 162, 22 N. E. 464, 17 Am. St. 291; Phillips v. Sanger Lumber Co. 130 Cal. 431, 62 P. 749; Mullanphy Sav. Bank v. Schnott, 135 Ill. 655, 26 N. E. 640, 25 A. S. R. 401; Welch v. Importers &c. Nat. Bank, 122 N. Y. 177, 25 N. E. 269; College Park Elec. B. L. v. Ide, 15 Tex. Civ. App. 273, 40 S. W. 64; Singer v. Salt Lake Copper Mfg. Co. 17 Utah 143, 53 Pac. 1024, 70 A. S. R. 773; Roy v. Scott, Hartley & Co. 11 Wash. 399, 39 P. 679; Rittenhouse v. Winch, 11 N. Y. S. 122; Gorder v. Plattsmouth &c. Co. 36 Neb. 548, 54 N. W. 840; Patterson v. Portland Smelting Works, 35 Ore. 96, 56 Pac. 467; Jones v. Hale, 32 Ore. 465, 52 Pac. 311.

Where mortgage bonds are valid at their inception, it is obviously within the power of a director of the corporation to buy them on the outside market from third persons. Seymour v. Spring Forest Cemetery Asso. 144 N. Y. 333. 39 N. E. 365, 26 L. R. A. 859. A purchase by a director immediately from the corporation of bonds of the par value of $18,000 for $16,000 cash has been held to be unobjectionable. Anderson v. Bullock County Bank, 122 Ala. 275, 25 So. 523.

security taken, is valid originally, whether liable to be avoided afterward or not.

Minority stockholders of a corporation cannot complain of an issue of mortgage bonds to a holder of the majority of the stock, when such issue was made by the corporation without fraud, for an adequate consideration, and with great benefit, though the bond issue was procured by the majority stockholder for use to raise money for himself, and was actually so used.[97]

§ 22a. **A fraudulent mortgage of corporate property to secure an existing indebtedness to directors will not be permitted,** although the directors have authority to borrow money for the use of the company.[98] When a corporation is insolvent, its directors who are its creditors cannot secure to themselves any advantage or preference over other creditors. If they do, equity will set aside the transaction at the suit of creditors of the corporation or their representatives, without reference to the question of any actual fraudulent intent on the part of the directors, for the right of the creditors does not depend upon fraud in fact but upon the violation of the fiduciary relation of the directors.[99]

It is not, however, a fraud on the corporation for directors making a *bona fide* loan to take the mortgage in the name of a person who is a mere figurehead and not to disclose to the other members of the board that they were the real parties who are lending the money. It is no violation of their duty as trustees to lend the money in the name of another rather than in their own names, unless the corporation thereby sustained some detriment.[101] But the lien of a director under

[97] Gloninger v. Pittsburg &c. R. Co. 139 Pa. St. 13, 21 Atl. 211.

[98] Olney v. Conanicut Land Co. 16 R. I. 597, 18 Atl. 181, 5 L. R. A. 361, 27 Am. St. 767; Assignment of Woolen Mills, In re, 101 Iowa 181, 70 N. W. 115; Koehler v. Black River Iron Co. 67 U. S. 715; Montgomery v. Phillips, 53 N. J. Eq. 203, 31 Atl. 622; Seeds Dry Plate Co. v. Heyn Photo Supply Co. 57 Neb. 214, 77 N. W. 660; Tillson v. Downing, 45 Neb. 549, 63 N. W. 836; Ingwerson v. Edgecombe, 42 Neb. 740, 60 N. W. 1032; Hill v. Pioneer Lumber Co. 113 N. Car. 173, 18 S. E. 107, 21 L. R. A. 560, 37 A. S. R. 621; Durlacher v. Frazer, 8 Wyo. 58, 55 Pac. 306, 80 Am. St. 918.

[99] Taylor v. Mitchell, 80 Minn. 492, 83 N. W. 418; Huling v. Huling's Lumber Co. 38 W. Va. 351, 18 S. E. 620. But see Corey v. Wadsworth, 118 Ala. 488, 25 So. 503, 44 L. R. A. 766.

[101] Schnittger v. Old Home &c. Min. Co. 144 Cal. 603, 78 Pac. 9.

a mortgage will be held inferior to that of bonus givers, claiming under a deed of trust of the same property, where the bonus subscriptions were induced by fraudulent representations for which the director is responsible.[102]

Since the rule is that directors cannot prefer their existing claims against their corporation by mortgages of corporate property, it is obviously contrary to the spirit of the law to allow them to obtain security upon claims which are merely contingent, as where they have indorsed corporation paper. Accordingly mortgages for such a purpose are held bad against creditors of the insolvent corporation.[103]

A corporation mortgage securing a note executed by a director personally is valid where the debt represented by the note is a corporation obligation and is evidenced in that manner merely to oblige the lender.[104]

The director of an insolvent corporation cannot execute a mortgage to his wife to secure a debt due him.[105]

§ 23. **A corporation though insolvent may make a valid mortgage** for the purpose of raising money to pay its debts and meet its current expenses. Such a transaction is not analogous to an assignment for the benefit of creditors, nor does it create any illegal preference.[106] It has the same right as an individual to pledge or mortgage its property.[107]

[102] Moore v. Universal Elevator Co. 122 Mich. 48, 80 N. W. 1015.

[103] Olney v. Conanicut Land Co., 16 R. I. 597, 18 Atl. 181, 5 L. R. A. 361, 27 A. S. R. 767; Scott v. Farmers' &c. Nat. Bank, 97 Tex. 31, 75 S. W. 7. But see Sanford &c. T. Co. v. Howe, Brown & Co. 157 U. S. 312.

[104] Allen v. Dayton Hotel Co. 95 Tenn. 480, 32 S. W. 962.

[105] Rowe v. Leuthold, 101 Wis. 242, 77 N. W. 153.

[106] Bergen v. Porpoise Fishing Co. 42 N. J. Eq. 397, 8 A. 523; Weihl v. Atlanta F. &c. Co. 89 Ga. 297, 15 S. E. 282; Milledgeville Co. v. McIntyre Store, 98 Ga. 503, 25 S. E. 567; Rollins v. Shaver W. &c. Co. 80 Iowa 380, 45 N. W. 1037; Bank of Montreal v. Salt & Lumber Co. 90 Mich. 345, 51 N. W. 512; Rock Spring Nat. Bank v. Luman, 6 Wyo. 123, 42 Pac. 874; Alberger v. Nat. Bank of Commerce, 123 Mo. 313, 27 S. W. 657; Chattanooga &c. R. Co. v. Evans, 66 Fed. 809; Coler v. Allen, 114 Fed. 609; Sidell v. Missouri Pac. R. Co. 78 Fed. 724. But see Jenkins v. John Good &c. M. Co. 56 App. Div. (N. Y.) 573, 68 N. Y. S. 239, holding a mortgage bad which forced creditors to extend time.

[107] Wilkinson v. Bauerle, 41 N. J. Eq. 635, 7 Atl. 514. Under § 64 of the New Jersey Corporation Act of 1896, a mortgage given by a corpora-

But if an insolvent corporation makes a mortgage of all its property to secure a debt to another corporation, and the mortgage is authorized at a meeting of the directors of the insolvent corporation, some of whom were also directors of the corporation for whose benefit the mortgage was made, the mortgage will be regarded as *prima facie* fraudulent and void, not only as to the grantor, but as to its stockholders and creditors.[108]

A mortgage by an insolvent corporation, pending a suit by a creditor and in violation of an injunction, is a nullity and the subsequent dismissal of the creditors' suit will not render the mortgage a valid instrument.[109]

§ 23a. Where a director is surety on a debt of the corporation, a mortgage of corporate property to secure or pay it may be valid, although the corporation is insolvent.[110] But where such a transaction

tion which is insolvent or which is contemplating insolvency, to secure money lent at the time it is given, is valid if the mortgagee be without notice of such insolvency or without notice that it is in contemplation. Contemplation of insolvency, within the meaning of this section, is something more than the contemplation of the possibility of insolvency on a contingency which does not in fact happen. Regina Music Box Co. v. Otto, 65 N. J. Eq. 582, 56 Atl. 715. But such a mortgage to secure existing indebtedness is invalid. Miller v. Gourley, 65 N. J. Eq. 237, 55 Atl. 1083. Even though the creditor receiving the mortgage is ignorant of the insolvency. Frost v. Barnert, 56 N. J. Eq. 290, 38 Atl. 956. *A fortiori* an insolvent corporation cannot prefer a director by mortgaging corporate property to him to secure an existing debt. Montgomery v. Phillips, 53 N. J. Eq. 203, 31 Atl. 622.

[108] Thomas v. Brownville &c. R. Co. 109 U. S. 522, 3 Sup. Ct. 315; James v. Railroad Co. 73 U. S. 752; Hope v. Salt Co. 25 W. Va. 789, 807; Sweeny v. Sugar Co. 30 W. Va. 443, 4 S. E. 431, 8 A. S. R. 88.

The mortgage and bonds of an insolvent company are void when the creditors secured had notice of the insolvency and the necessary effect of the transaction was to hinder and delay other creditors. Age-Herald Co. v. Potter, 109 Ala. 675, 19 So. 725; Smith v. Brandt Printing Co. 97 Tenn. 351, 37 S. W. 10; Tradesman Pub. Co. v. Car Wheel Co., 95 Tenn. 634, 32 S. W. 1097, 31 L. R. A. 593, 49 Am. St. 943.

[109] Bissell v. Besson, 47 N. J. Eq. 580, 22 Atl. 1077.

[110] First Nat. Bank v. Dovetail &c. G. Co. 143 Ind. 550, 40 N. E. 810, 52 A. S. R. 435; Milledgeville Co. v. McIntyre Store, 98 Ga. 503, 25 S. E. 567; Worthen v. Griffith, 59 Ark. 562, 28 S. W. 286; Waggoner-Gates M. Co. v. Ziegler-Zaiss Com. Co. 128 Mo. 473, 31 S. W. 28.

is part of a fraudulent scheme to wreck the company and appropriate its assets, it is not a legitimate exercise of the director's authority and the mortgage is invalid.[111] And the general rule is not recognized in Nebraska where an insolvent corporation cannot prefer a debt on which its officers and directors are bound as sureties.[112]

Creditors who are neither directors or stockholders, but strangers to the corporation, are not disabled from taking security from the corporation by reason of the fact that upon the paper they hold there is also the indorsement of directors. Such creditors need not be content to share equally with other creditors because they have a guaranty which may be worthless. Furthermore as long as a corporation, though technically insolvent, is a going concern, expecting in good faith to continue in business, a mortgage to secure its directors as accommodation indorsers is valid, such mortgage being not merely to secure past indebtedness but to secure an extension of credit.[113]

Where a majority of the quorum of directors authorizing a mortgage are interested parties by reason of personal indorsements on the corporation paper secured, the mortgage executed in pursuance of such vote has been held invalid in accordance with the doctrine that a director is not qualified to vote on a matter where he has a personal interest.[114]

§ 23b. **Furthermore an insolvent corporation cannot make a mortgage for a purpose forbidden by statute,** such as a mortgage to secure preferred stockholders where a preference to such a class is prohibited. Honest belief by the officers that they had a right to secure such stockholders will not overcome the presumption of a fraudulent intent.[115] But in the absence of statutory prohibition an insolvent corporation may execute a mortgage to secure a *bona fide* antecedent debt,[116] even

[111] Hanley v. Balch, 94 Mich. 315, 53 N. W. 954.

[112] Tillson v. Downing, 45 Neb. 549, 63 N. W. 836; National Wall Paper Co. v. Columbia Nat. Bank, 63 Neb. 234, 88 N. W. 481, 56 L. R. A. 121; Merchants' Nat. Bank v. McDonald, 63 Neb. 363, 88 N. W. 492, 89 N. W. 770; Williams v. Turner, 63 Neb. 575, 88 N. W. 668.

[113] Sandford Fork &c. Co. v. Howe, 157 U. S. 312, 15 S. Ct. 621; New Memphis Gaslight Co. Cases, 105 Tenn. 268, 60 S. W. 206, 80 Am. St. 880.

[114] Swift & Co. v. Dyer-Veatch Co. 28 Ind. App. 1, 62 N. E. 70.

[115] Reagan v. First Nat. Bank, 157 Ind. 623, 61 N. E. 575, 62 N. E. 701.

[116] Shaw v. Robinson, 50 Neb. 403, 69 N. W. 947; Nathan v. Lee, 152 Ind. 232, 52 N. E. 987, 43 L. R. A.

though the preferred creditor is another corporation, and both debtor and creditor have the same president and have common stockholders.[117]

A general statute of the state where a corporation is organized will not invalidate a mortgage within the charter powers of the corporation and valid under the laws of the state where it is made. Thus where a New York corporation removes to New Jersey and executes a mortgage on property there to secure resident creditors for debts contracted and payable there, which mortgage is valid in New Jersey and by the law under which the corporation is created, it will not be held invalid because the execution is contrary to a general statute of New York forbidding a transfer to creditors in contemplation of insolvency.[118] And where a corporation has not refused to pay its debts and gives the mortgage with the honest intention of continuing business, the mortgage is not invalid under the New York statute forbidding certain transfers by insolvent corporations.[119]

By statute in North Carolina a mortgage made by a corporation is invalid as against existing creditors who commence action within sixty days after registration of the mortgage and a purchaser of land at a foreclosure sale under such mortgage acquires no rights as against the creditor. The statute does not authorize the declaration of a lien but only puts the mortgage out of the way of the creditor's collecting his debt.[120]

§ 23c. In Washington an insolvent corporation cannot make a valid mortgage of its property. When it has reached the point where its debts are equal to or greater than its property, and it cannot pay in the ordinary course, and its business is no longer profitable, it ought to be wound up and its assets distributed.[121] But where a corporation

820; Seeds Dry Plate Co. v. Heyn Photo-Supply Co. 57 Neb. 214, 77 N. W. 660; Smith v. Wells Mfg. Co. 148 Ind. 333, 46 N. E. 1000.

[117] Sells v. Rosedale &c. Co. 72 Miss. 590, 17 So. 236.

[118] Boehme v. Rall, 51 N. J. Eq. 541, 26 A. 832.

[119] Swan v. Stiles, 94 App. Div. (N. Y.) 117, 87 N. Y. S. 1089, construing § 48 of the Stock Corp. L. See Rogers Const. Co., Matter of, 79 App. Div. (N. Y.) 419, 79 N. Y. S. 444.

[120] Langston v. Greenville &c. Co. 120 N. Car. 132, 26 S. E. 644; Code of N. Car., § 685.

[121] Thompson v. Huron Lumber Co. 4 Wash. 600, 30 Pac. 741; Conover v. Hull, 10 Wash. 673, 39 Pac. 166, 45 Am. St. 810; Biddle Purchasing Co. v. Port Townsend &c. Co. 16 Wash. 681, 48 Pac. 407; Van Brocklin v. Queen City Printing Co. 19 Wash. 552, 53 Pac. 822.

is a going concern and its debts are only sixty-six per cent. of its assets it can make a valid mortgage even under the law of this state.[122] A transfer of the equity of redemption to the mortgagee is unobjectionable, the property mortgaged being less in value than the debt secured.[123]

§ 24. A corporation may be estopped from setting up the defense of ultra vires to its obligation in the hands of a holder in good faith for value, who cannot be presumed to have had any knowledge of the want of authority to make the contract. Of course, if the contract be absolutely prohibited by the charter of incorporation, or by a general statute, or if the law implies such a prohibition from the purposes for which the corporation was created, all persons dealing with it are bound to take notice of the extent of the company's powers. But when there is no apparent want of power in the corporation to incur the obligation, whether note, bond, or mortgage, and there is nothing on the face of the paper by which the debt is evidenced showing that the company has overstepped the limits of its power, the corporation is estopped from denying that which, by assuming to make the contract, it had virtually affirmed.[124]

A restriction in a corporate charter as to the amount of mortgage bonds which can be issued by the corporation does not enable a creditor of the corporation to invalidate an overissue on the ground of *ultra vires*. The company could not avail itself of such a defense as long as it retained the proceeds of the contract and a creditor would

[122] Strohl v. Seattle Nat. Bank, 25 Wash. 28, 64 Pac. 916. See also Manhattan Trust Co. v. Seattle Coal &c. Co. 19 Wash. 493, 53 Pac. 951.

[123] Klosterman v. Mason County &c. R. Co. 8 Wash. 281, 36 Pac. 136.

[124] Hays v. Galion Gas Light &c. Co. 29 Ohio St. 330; Bissell v. Michigan &c. R. Co. 22 N. Y. 258, 289; Monument Nat. Bank v. Globe Works, 101 Mass. 57; Whitney Arms Co. v. Barlow, 63 N. Y. 62; Singer v. St. Louis &c. R. Co. 6 Mo. App. 427; Farmers' Bank v. Ohio River &c. Steamboat Co. 108 Ky. 447, 56 S. W. 719; Woodcock v. First Nat. Bank, 113 Mich. 236, 71 N. W. 477. See also Picard v. Hughey, 58 Ohio St. 577, 51 N. E. 133. If the corporation assumes to have the authority to mortgage, receives the money and applies it to corporate purposes, it will not be heard to raise the question of *ultra vires*. Union Trust Co. v. Mercantile &c. Co. 189 Pa. St. 263, 42 A. 129; Bear Creek Gap &c. Co. v. American &c. Co. 127 Fed. 625; Savings & Trust Co. v. Bear Val. Ice Co. 113 Fed. 693; Sioux City &c. R. & W. Co. v. Trust Co. 82 Fed. 124. See **Chapter VI.**

be in no better position in this respect than the company. Furthermore an overissue of substituted bonds, made after the rights of an attachment creditor were fixed, would furnish him no ground to attack the original issue which was not in excess of the permitted amount.[125]

In an equitable proceeding to cancel a corporate mortgage because certain requirements regarding a stockholders' vote of authorization have not been complied with, the company cannot come into a court of equity to avail itself of the invalidity of the mortgage, without offering to do equity by restoring the amount remaining due on the mortgage.[126]

[125] International Trust Co. v. Davis & Farnum Mfg. Co. 70 N. H. 118, 46 A. 1054; Underhill v. Santa Barbara &c. Co. 93 Cal. 300, 28 Pac. 1049; Beach v. Wakefield, 107 Iowa 567, 76 N. W. 688, 78 N. W. 197. In the last case the court say: "A distinction is to be taken between contracts like this and those which, independent of statute, are in violation of public policy. The creation of this indebtedness involved no moral turpitude. The making of the mortgage did not disable the corporation from performing its duties to the public. The Terminal Company had a right to incur a debt, and to execute a mortgage to secure it. The only ground of complaint is that it went further than the law permitted. Of this the state may complain, but the Terminal Company cannot; nor can any person whose rights are derived through the Terminal Company, and who acquired such rights with knowledge of the mortgage lien." The court also held that the quasi-public character of the corporation did not alter the general rule.

A judgment creditor cannot attack the validity of a mortgage because the amount secured exceeds the legal debt limit. Beels v. North Nebraska F. & D. P. Ass'n, 54 Neb. 226, 74 N. W. 581.

In Kentucky the rule is otherwise. The mortgage securing the excessive debt is legal and, to the extent the claim secured by it is legal, will be upheld. As to the amount in excess of the legal indebtedness, the mortgage creditor is not entitled to enforce his contract, but, as between himself and the company, to restitution in an action for money had and received. General creditors are entitled to *pro rata* distribution after the legal debt secured by mortgage has been satisfied; but the mortgagee cannot share in such distribution for the balance due him. Bell & Coggeshall Co. v. Kentucky Glass Works Co. 106 Ky. 7, 52 S. W. 2, 1092, 51 S. W. 180; First Nat. Bank v. D. Kiefer Milling Co. 95 Ky. 97, 23 S. W. 675.

Stockholders guaranteeing corporation paper cannot complain that an excessive amount was issued and the assets of the corporation applied in payment of the excessive part of the issue. Taylor v. Matheson, 86 Wis. 113, 56 N. W. 829.

[126] Southern B. Asso. v. Casa Grand Stable Co. 128 Ala. 624, 29 So. 654.

Where an *ultra vires* mortgage is made by a foreign corporation and the property is subsequently conveyed to a domestic corporation which expressly binds itself to pay the mortgage indebtedness, the domestic corporation is thereby estopped to deny the validity of the mortgage. The express covenant to pay all the present indebtedness cannot be controlled by general language following whereby the grantee undertakes to perform all the "lawful obligations" of the grantor.[126]

§ 25. **When the authority to mortgage is coupled with a condition for the benefit of the state,** the state alone can enforce it. An act authorizing a company to borrow money and mortgage its property to secure the payment of it, upon condition of paying or securing certain bonds issued to the company by the state, when accepted by the company, is a contract between the company and the state, but is not a contract between the company and the holders of the state bonds referred to, and they cannot maintain an action thereon against the company. There was originally no relation of debtor and creditor between the company and the bondholder, and the act did not create any such relation. Upon the failure of the company to fulfil the condition on which the privilege accorded by the act was granted, it became amenable to the state and not to strangers to the contract.[127]

§ 26. **Forfeiture of the charter of a corporation.**—When the charter of a railroad company provides that unless the road be completed by a certain day the company shall forfeit to the state its corporate franchises and rights, together with its road and all its property, and the company having authority by its charter to issue bonds secured by mortgage exercises this power, but failing to complete the road, the state proceeds to declare the charter forfeited, and to take possession of the road and turn it over to persons who originally subscribed money for it, the state takes the property and franchises free from the incumbrance of the mortgage. The authority to make the mortgage and the condition of forfeiture, being parts of the same

[126]* Alvord v. Spring Valley Gold Co. 106 Cal. 547, 40 Pac. 27. A corporation cannot contest a mortgage executed by it on the ground that it was *ultra vires* for it to acquire the property covered by the mortgage. Butterworth v. Kritzer Milling Co. 115 Mich. 1, 72 N. W. 990.

[127] Stuart v. James River &c. Co. 24 Gratt. (Va.) 294.

statute, must be construed together. If the act should be construed as investing the company with the rights to aliene or mortgage all its franchises, rights, and property, free from the right of the state to declare a forfeiture of the same, the act would be in part nullified; for in that case the very property which is to be forfeited to the state becomes vested in others by the mortgage, and nothing is left upon which the forfeiture could operate. The idea that only the equity of redemption is subject to forfeiture is also repugnant to the provision that the road and all its property shall be forfeited.[128]

Of course such a provision for the forfeiture of the charter of a company would, if known, prevent the sale of the company's funds in the market. The loan could be disposed of only to persons having a personal interest in the company, or personal confidence in its officers. Whether purchasers of such bonds had actual notice of the restriction of the company's power of executing a mortgage or not, they would in law be chargeable with such notice. They must be presumed to know the conditions annexed to the grant of power made by the charter or statute under which the corporation was organized. The purchasers of such bonds cannot claim the position of *bona fide* holders without notice of the rights and equities of the state.

II. Statutes authorizing Railroad Companies to mortgage their Property and Franchises.

§ 27. General statement.—In recognition of the doctrine that legislative authority is essential to the making of a valid mortgage by a corporation chartered for public purposes, and to this end having important privileges granted them, general laws have been enacted in almost all the American states conferring upon railroad corporations the power to mortgage their property and franchises.[129] These cor-

[128] Silliman v. Fredericksburg &c. R. Co. 27 Grat. (Va.) 119.

[129] **Alabama:** Code 1876, §§ 2048, 2052, and Code 1886, § 1664; Code 1896, § 1163, par. 14.

Arizona: R. S. 1901, § 866.

Arkansas: Dig. of Stats. 1874, § 4970; Dig. of Stats. 1884, § 5488.

California: Civ. Code, §§ 456, 457, with amendments of 1880; Codes & Stats. 1885; Civil Code, §§ 456, 457. Under this statute a railroad company may issue its bonds for the purposes named upon a majority vote of the board of directors. McLane v. Placerville &c. R. Co. 66 Cal. 606, 6 Pac. 748.

Colorado: G. Laws 1877, §§ 301,

porations are so numerous and their functions so important, not only has the public convenience demanded that there should be general

306; G. S. 1883, § 336; Mills' Anno. Stats. 1891, § 602.

Connecticut: G. S. 1875, pp. 332, 333; G. S. 188, §§ 3570–3572; G. S. 1902, § 3848.

Dakota, North: R. Codes 1895, § 2947. **South:** R. Codes 1904, § 489.

District of Columbia: R. S. 1874, § 643.

Florida: Bush's Dig. 1872, p. 166; Dig. of Laws 1881, p. 279; R. S. 1892, §§ 2241, 2242; G. S. 1906, § 2803.

Georgia: Code 1882, § 1689; Code 1895, § 2167.

Idaho Territory: R. S. 1887, §§ 2664, 2665; Civil Code 1901, § 2164.

Illinois: R. S. 1877, ch. 114, § 20; Annot. Stat. 1885, p. 1914; R. S. 1895, ch. 114, § 20, par. 10, and § 35. As to the provision requiring the concurrence of the holders of two-thirds in amount of the stock, see Hervey v. Illinois &c. R. Co. 28 Fed. 169.

Indiana: 1 R. S. 1876, p. 706; Act of May 11, 1852; 2 R. S. 1888, § 3911; 2 Burns' R. S. 1901, § 5168.

Iowa: Code 1873, §§ 1283–1287, 1301; R. Code 1880, §§ 1283–1287; McLain's Code, §§ 1965, 1966. Construed in Sioux City T. R. &c. Co. v. Trust Co. 82 Fed. 124.

Kansas: Gen. Stats. 1897, c. 70, § 2, par. 9; Dassler's Stat. 1876, vol. 1, p. 167; Comp. Laws 1885, § 1176.

Louisiana: 2 R. L. 1904, pp. 1479, 1480; R. S. 1870, and R. S. 1884, §§ 692, 693, 726, 727, 2396, 2397, 2427, 2428.

Maine: R. S. 1871, p. 454; R. S. 1883, ch. 51, § 56; R. S. 1903, ch. 52, § 32.

Maryland: Pub. Gen. L. 1904, vol. 1, art. 23, § 258; Laws 1870, p. 903; 1 Pub. Gen. Laws 1888, art. 23, § 171.

Massachusetts: R. S. 1902, ch. 111, § 63; Acts 1874, ch. 372, §§ 49, 50, 51, 52; Acts 1875, ch. 58; Acts 1876, ch. 170; Pub. Stat. 1882, ch. 112, §§ 62, 80. See Chadwick v. Old Colony R. Co. 171 Mass. 239. For previous statutes see Acts 1854, ch. 286; G. S. 1860; ch. 63, §§ 120–123. Bonds issued in violation of these statutes are void. East Boston Freight R. Co. v. Hubbard, 92 Mass. 459; Commonwealth v. Smith, 92 Mass. 448.

Michigan: Laws 1873, p. 527; Annot. Stat. 1882, § 3352; Comp. L. 1897, §§ 6334, 6335, 6340.

Minnesota: 1 Stat. at Large 1873, p. 430; R. L. 1905, §§ 2901, 2902.

Missouri: Wagner's Stat. 1872, p. 298; R. S. 1879, § 765; Laws Ex. Sess. 1887, p. 8; R. S. 1899, § 1035.

Montana: Laws 1873, § 14; Comp. Stat. 1887, p. 816, § 691; Civil Code 1895, § 913.

Nebraska: G. S. 1873, ch. 11, §§ 84, 117–119; Comp. Stats. 1885, ch. 16, §§ 117–119; Comp. Stats. 1905, § 2075, ch. 16, § 117.

Nevada: Comp. Laws 1873, p. 292, § 3440; G. S. 1885, § 849; Comp. L. 1900, § 986.

New Hampshire: G. L. 1867, ch. 133, § 6; ch. 144, §§ 3, 4; ch. 145, § 2; G. L. 1878, ch. 159, § 2; Pub. Stats. 1901, ch. 156, § 46.

New Jersey: Laws 1873, ch. 413, § 20; 2 R. S. 1877, p. 931, § 108; Laws 1877, ch. 85, § 14; 2 R. S. 1877,

laws upon the subject doing away with the necessity of special legislation, so often as such corporations may have occasion to exercise this power, but also has the public welfare demanded that the authority conferred should be uniform, and that it should be regulated and restricted in a uniform manner.

The statutes upon this subject in the several states are referred to because they are the foundation of most of the railroad mortgages now existing in this country, and will be the foundation of many others yet to be made. That similar statutes do not exist in relation to

p. 940, § 142; Laws 1878, p. 20; G. S. 1895, p. 2648.

New Mexico Territory: Acts 1878, p. 35, § 14; Comp. Laws 1884, § 2700; Comp. Laws 1897, § 3890.

New York: Rev. Stat. 1875, p. 533, § 39, pl. 10; Ibid. p. 550, § 90; R. S. 1889, p. 1752. Same in General R. R. Act 1850; Laws 1850, ch. 140. § 28, pl. 10; Laws 1878, ch. 163; Heydecker's G. L. & R. S. 1901, pp. 3253, 3254.

North Carolina: Revisal 1873, p. 740, ch. 99, § 29; Code 1883, ch. 49, § 1957, pl. 10; Code §§ 671–675, 691. Construed in Central Trust Co. v. Western &c. R. Co. 89 Fed. 24.

Ohio: 1 R. S. 1860, ch. 29, § 31; 1 R. S. 1880, §§ 3286–3290. As to bonds and mortgages of narrow-gauge railroad companies, see Laws 1877, p. 146; Supp. R. S. 1884, § 3309a; Bates Anno. Stats. 1905, §§ 3287, 3288.

Pennsylvania: Brightly's Purdon's Digest 1883, p. 1422, § 41; Laws 1873, p. 45, § 21; construed in New Castle &c. R. Co. v. Simpson, 21 Fed. 533.

Tennessee: Code 1858, p. 315, § 1443; Comp. Stat. 1871, § 1443; Code 1884, § 1277; Code 1896, §§ 1541, 1542. The act of Tennessee March 15, 1881, conferring the power to mortgage in very broad terms, and extending such power to all railroad companies then existing, or which might thereafter be created, does not repeal the limitation upon the power contained in Act March 24, 1877, there being no repealing provision in the act, and no such repugnancy between the two acts as to imply a repeal. Frazier v. East Tennessee &c. Co. 88 Tenn. 138, 12 S. W. 537.

Texas: Laws 1876, ch. 97, § 23; R. S. 1879, arts. 4219, 4220. As to ratification of mortgage not so authorized, see Texas &c. R. Co. v. Gentry (Tex.), 8 S. W. 98; Sayles Civil Stats. 1897, arts. 4487, 4488; Supp. to same 1904, art. 4584n.

Utah Territory: 2 Comp. Laws 1888, §§ 2368–2371; R. S. 1898, § 444.

Vermont: G. S. 1870, ch. 26, §§ 97–99; R. L. 1880, § 3350.

Virginia: Code 1873, ch. 61, § 43; Acts 1836, p. 111, § 29; Code 1887, § 1232; Code 1904 (Pollard), § 1105e.

West Virginia: Acts 1872, ch. 88, §§ 20, 22; Acts 1877, ch. 3; Code 1887, ch. 54, § 50, pl. 12; Code 1899, ch. 50, pars. 11, 12.

Wisconsin: Laws 1877, ch. 144, § 1; R. S. 1878, § 1828, pl. 10; Comp. Stats. 1898, ch. 87, par. 10.

Wyoming Territory: R. S. 1887, § 549, R. S. 1899, § 3201.

mortgages by other corporations arises from the fact that there are very few other corporations that stand in the same relation to the public that railroad companies do, having corporate privileges which they cannot transfer. In the few instances of corporations having similar public duties and privileges, such for instance as canal companies, special legislation is adequate. In a few states, authority to mortgage is still given to railroad companies only by charter or by special act.

The constitutions of the states of Alabama,[130] Arkansas,[131] California,[131*] Colorado,[132] Illinois,[133] Nebraska,[134] Pennsylvania,[135] and Texas,[136] provide that no corporation shall issue stock or bonds except for labor done, services performed, or money or property actually received, and that all fictitious increase of stock or indebtedness shall be void. In West Virginia[137] a similar provision is made by statute; and the constitutions of the states of Alabama, Arkansas, and Pennsylvania also provide that the stock and indebtedness of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock be first obtained, at a meeting to be held after sixty days' notice given in pursuance of law.

Not less important than legislative authority to railroad companies to mortgage their property and privileges is legislative authority to those who may become purchasers under such mortgages to organize themselves as corporations, so that they can adequately use and enjoy

[130] Const. of 1875, art. xiii, § 6; Code 1876, p. 148; Code of Ala. 1896, Const. of 1875, art. xiv, § 6, p. 100. For manner of giving notice, etc., see §§ 2031–2035 of Code 1876. In this state thirty days' notice is provided for instead of sixty.

[131] Sandels & Hill Digest of Stats. 1894, Const. 1874, art. xiii, § 8; construed in Memphis &c. R. Co. v. Dow, 120 U. S. 287, 7 S. Ct. 482.

[131] Treadwell Const. Anno. 1902; Const. 1876, art. xii, § 10.

[132] Const. of 1876, art. xv, § 9; Mills' Anno. Stats. 1891, Const. 1876, art. xv, § 9.

[133] R. S. 1905 (Hurd), Const. 1870, art. xi, § 13; Annot. Stat. 1885, p. 1915. This does not prohibit the raising of funds for legitimate corporate purposes by the sale of stocks or bonds. Peoria &c. R. Co. v. Thompson, 103 Ill. 187.

[134] Comp. Stats. Anno. 1905, Const. 1875, art. xi, § 5.

[135] Const. of 1873, art. xvi, § 7; Buckalew's Const. Penn. 1883; Const. of 1874, art. xvi, § 7; Brightly's Purdon's Dig. Pa. Stats. 1894, Const. 1874, art. xvi, § 191; Ahl v. Roads, 84 P. S. 319.

[136] R. S. 1895, Const. of 1876, art. xi, § 6.

[137] Code Anno. 1906, Acts 1877, ch. 3, § 2469.

what they have purchased; and, accordingly, statutes for this purpose have been enacted in nearly all the states. These will be given in a subsequent chapter.[138]

A terminal railway and warehouse company for the construction and operation of a line of railway in a city, with all terminal facilities is a railroad corporation within the meaning of a statute authorizing railroads to mortgage their property and franchises.[139]

§ 27a. **A city ordinance forbidding the assignment of the franchise to operate a street car line** does not preclude the company from mortgaging its track and rolling stock under general statutory authority. This clause does not say that the company shall not mortgage or alienate its property but only provides that the consent therein given shall never authorize any other railway company to use the franchise. In other words the license granted by the city is restricted specially to the original company. This provision is for the benefit of the city, enabling it to impose additional burdens upon any subsequent licensee. If the mortgage is foreclosed, the purchaser runs the risk of getting the city's consent to operate the purchased property, but the mortgage is not *ultra vires*.[140]

[138] Chapter XXI.

[139] Beach v. Wakefield, 107 Iowa 567, 76 N. W. 688, 78 N. W. 197.

[140] Wells v. Northern Trust Co. 195 Ill. 288, 63 N. E. 136, affirming 90 Ill. App. 460.

CHAPTER II.

FORM AND CONSTRUCTION OF CORPORATE MORTGAGES.

I. Common kinds of corporate mortgages, §§ 28–32.
II. Equitable mortgages, §§ 33–38.
III. Statutory liens and mortgages, §§ 39–44.
IV. Who may execute a corporate mortgage, §§ 45–49.
V. Construction of various provisions of corporate mortgages, §§ 50–64.

I. Common Kinds of Corporate Mortgages.

§ 28. **Mortgages of railroad companies and other corporations are almost invariably in the form of trust deeds,** with a power of sale. The intervention of trustees to take and hold the mortgage title for the benefit of the creditors secured, and to represent them in all important matters, connected with the security, and especially in the enforcement of it, is almost, if not altogether, a necessity of corporate mortgages of the magnitude common with these securities. The holders of the bonds secured by such mortgages are often very numerous, and scattered all over the world. The bonds are made negotiable, so that they may be conveniently disposed of in the market, and the bondholders do not remain the same from year to year, but are constantly shifting.[1] Through the intervention of trustees the mortgage is in effect a contract between the corporation making it and all persons who may become holders of the bonds secured by it, and they are entitled to the same benefit they would have if made parties to the deed.[2]

It is usual in corporate mortgages to convey the property in trust to two or more trustees jointly, so that upon the death of a trustee his interest does not descend to his heirs, but vests in the survivor. This right of survivorship is not affected by statutes abolishing joint-tenancies and converting them into tenancies in common, unless the

[1] See 2 Jones Mortgages, §§ 1764–1771.

[2] Butler v. Rahm, 46 Md. 541; McLane v. Placerville &c. R. Co. 66 Cal. 606, 6 Pac. 748; Chamberlain v. Connecticut &c. R. Co. 54 Conn. 472, 9 Atl. 244.

language of the statutes expressly embraces trust estates; for the evil to be remedied by such statutes is the improper accretion to the survivor of that which belonged in part to the deceased; and inasmuch as trust property, whether held by one or more persons, would only be held for the benefit of the *cestuis que trustent,* whose estate would be in no manner affected by the death of one of the trustees, the reason of the law ceases, and the law itself does not apply.[3]

A trust deed is regarded as in effect a mortgage,[4] and whether the legal title passes by such a deed or not is usually determined according to the rule adopted as to the effect of a mortgage deed upon the legal title.[5]

The right of possession under a trust deed as well as under a mortgage, until default and a demand of possession, remains in the grantor or mortgagor.[6]

§ 29. **Although railroad mortgages generally contain a power of sale which the trustees may exercise upon default, it is not often that this power is resorted to** for the enforcement of these securities. The property of such corporations is generally widely scattered, and in the hands of a great number of persons; and generally, too, there are conflicting interests arising from mortgages and other liens in favor of other persons. These considerations are generally sufficient to render it desirable and proper for mortgagees to resort to proceedings in equity to foreclose such mortgages rather than to exercise the summary rights conferred by powers of sale.

§ 30. **Indefiniteness in a power of sale will render it void.** Thus the York and Cumberland Railroad Company[7] executed a mortgage, in the condition of which it was provided that upon failure of payment for the term of sixty days the holder of the bonds secured, or of any one or more thereof, was authorized to take possession for the common benefit and use of the holders of all the bonds, "and such holders shall share and share alike in the disposition and sale of the

[3] McAllister v. Plant, 54 Miss. 106.

[4] Wisconsin &c. R. Co. v. Wis. Riv. L. Co. 71 Wis. 94, 36 N. W. 837.

[5] Jones Mortgages, §§ 62, 1769; Southern Pacific R. Co. v. Doyle, 8 Sawy. (U. S.) 60.

[6] Southern Pacific R. Co. v. Doyle, 8 Sawy. (U. S.) 60.

[7] Mason v. York &c. R. Co. 52 Me. 82.

same for that purpose by public vendue, on reasonable notice given thereof to the grantors aforesaid, first deducting from such proceeds all costs and expenses incident to such possession and sale." A power of sale is not given in terms by the mortgage, nor is it necessarily implied from it. Moreover, if a power were assumed to exist, it would be void from the indefiniteness of the persons upon whom it is conferred, and from the impossibility of its execution. It is given to no one specifically. If one may sell, so may another. If one wished to sell, and the others objected to a sale, the exercise of the power could not be prevented. The bondholders, moreover, might severally proceed to sell; but if the sales should be made at the same time, at different places, and upon different terms and conditions, who, of the bondholders thus selling, will confer a valid title upon the purchaser? No estate is conferred upon the bondholders as such. This is conferred upon the mortgagee; but the power of sale, if conferred upon any one, is not conferred upon him. The mortgagee having attempted to exercise the power of sale, and having transferred to the purchaser all his right, title, and interest in the mortgage, it was held that the purchaser took an assignment of the mortgage and held the mortgage title in the same manner that the mortgagee had held it.

§ 31. **When bonds are secured by a conveyance strictly in the form of a mortgage** rather than a trust deed, the mortgagee, after a transfer of any of the bonds, holds the legal title as mortgagee for his remaining interest and in trust for the holders of the bonds transferred.[8]

§ 32. **Debentures, which are the commonest form of security issued by English corporations, are defined** to be instruments under seal, creating a charge, according to their wording, upon the property of the corporation, and to that extent conferring a priority over subsequent creditors, and over existing creditors not possessed of such a charge.[9] This is the true and proper use of the term; although it is frequently applied on the one hand to instruments which do not confer a charge, and which are nothing more nor less than ordinary unsecured bonds, and on the other to instruments which are more than a

[8] 1 Jones Mortgages, § 817; Mason v. York &c. R. Co. 52 Me. 82; York &c. R. Co., In re, 50 Me. 552.

[9] Brice Ultra Vires, 2d ed. 279.

mere charge, being in effect mortgages, and are properly termed mortgage debentures. Debentures, strictly so called, differ from mortgages in not conferring upon the grantees the legal title, or any of the ordinary rights of ownership of the property upon which a charge is created.[10] They are at most only equitable mortgages. The charge they create upon the property of the company confers only equitable rights, either as against other creditors or as against the corporation; and in fact the true test whether an instrument is a debenture or mortgage is found in the inquiry whether the holder has any legal right to interfere with the company's use or control of the property in whatever way it pleases. If the instrument confers a charge which can be protected and enforced only in equity, it is strictly a debenture.[11] Of course the effect and extent of the charge depend entirely upon the language used.[12]

Such debentures are in effect statutory mortgages. It will be noticed that the English railway mortgages differ widely from those in use in America, in that each creditor is there secured by a separate mortgage, while here one mortgage is made to secure all the mortgage creditors.

Under the Companies Clauses Act,[13] holders of mortgage debentures of a corporation have no priority as respects each other, but are all upon an equality. One mortgage debenture holder is not entitled to acquire an advantage over the other mortgage debenture holders. After a bill in equity against the company has been filed by all the debenture holders, and a receiver appointed, a single mortgagee, who has recovered judgment on his debenture, is not entitled to sue out an execution otherwise than as trustee for himself and the other mortgage debenture holders.[14]

II. Equitable Mortgages.

§ 33. **An instrument which was intended to be the mortgage deed** of a corporation, but which, not being executed by the corporation, or in its name, cannot take effect as its deed, may nevertheless be regarded as an equitable mortgage, and entitle the holders of it in

[10] To assist in understanding the English decisions, forms of these instruments were given in the first edition of this work.

[11] See Holroyd v. Marshall, 10 H. L. Cas. 191.

[12] General Southern American Co., In re, L. R. 2 Ch. D. 337.

[13] 8 Vict. 16, § 42.

[14] Bowen v. Brecon R. Co. L. R. 3 Eq. 541.

equity to the full benefit of the security intended to be given. The Rutland and Washington Railroad Company authorized its president to issue bonds secured by a mortgage of its road and franchise. The president executed an instrument which recited his authority, proceeded in his name as president to convey the property in mortgage, and to make the covenants, and the deed was signed in his own name. The company issued bonds under this mortgage, and did various acts in ratification of the security, and afterwards issued two other sets of bonds, and secured them by second and third mortgages executed in due form. The first bonds not being paid when due, the trustees filed a bill to foreclose the mortgage, whereupon the subsequent mortgagees claimed that the first mortgage, by reason of its defective execution, did not constitute a lien upon the property. The court, however, sustained it as an equitable mortgage.[15] As against the corporation itself, the bonds and mortgage were binding contracts. Objection was made that the mortgage was not a memorandum in writing sufficient to satisfy the statute of frauds. The vote of the directors in connection with the deed was regarded as sufficient in this respect, and as furnishing an equitable right in the security contracted to be given. It was also objected that a court of equity would not give relief for mistake in matter of law; but there was no occasion to discuss this question, because there was no mistake on the part of the corporation as to matter of law; for the intention was that the president should make a valid technical mortgage, and it was altogether a mistake on his part that it was not technically the deed of the corporation. He by mistake made one that technically could operate only as his own deed.

But after determining that the instrument constituted an equitable mortgage between the parties, it remained to establish it as such against the subsequent mortgagees. The court was convinced by the evidence that all the trustees under the second and third mortgages, prior to and at the time such mortgages were executed, had notice and knowledge, in point of fact, that the first bonds had been issued, and that they were secured by mortgage. They stood chargeable, there-

[15] Miller v. Rutland &c. R. Co. 36 Vt. 452. Where there was no recital of the authority of the president to sign a corporation mortgage and the president signed his own name with only the word "Pres." after it, it was held that such instrument could not be enforced as an equitable mortgage. Brown v. Farmers' Supply Co. 23 Or. 541, 32 Pac. 548.

fore, with the legitimate effect of the right, whether legal or equitable, which existed in virtue of the issuing of the bonds with such security by way of mortgage as appertained to them. The trustees under these mortgages were the agents of the holders of the bonds, and notice to the agent was notice to the bondholders, who therefore took their bonds subject to all the legal consequences of the existence of the equitable first mortgage. Notice to the trustees should be held to affect the title in their hands, with reference to all rights existing in respect thereto under the trust.[16]

§ 34. **A contract to give a mortgage** for specified sums has in equity the effect of a mortgage to the extent indicated. But such a contract implies that no other or different mortgage or lien is to be given; and a stipulation for a mortgage "for the advancements made

[16] "Though it be obvious and readily conceded," said Mr. Justice Barrights, in reference to the security provided by the mortgage in trust, by the purchase of the bonds, and with such purchase the trustees have no connection, nor any agency in reference to the transfer thereof, yet it is at the same time true, that, in reference to the security for holding, enforcing, and administering it according to the provisions of the trust, the trustees are the agents of the parties interested and entitled by reason of being bondholders. We are unable to assent to the proposition, that the trustees are only agents of the *cestui que trust* for holding the legal title. They are agents for holding just such title as is created by the transaction, and for administering it according to the terms of the trust; and whatever title the *cestui que trust* has, whether legal or equitable, is through, and in virtue of, the title conveyed to and held by the trustees. Even if it should be granted that the trustees were agents merely for holding the legal title, still, as the rights of the *cestui que trust* depend upon and are to be asserted through that legal title, whatever affects such legal title in its creation in the trustees must affect the rights and interests that are dependent upon it. If the legal title is charged with an incumbrance in its creation in the hands of the trustees, it is difficult to see how the *cestui que trust* can have an equity suspended upon that legal title that shall override such incumbrance. However that might be as a proposition applicable to a dry trust, still, as to a trust which, in addition to the holding of the title, is administrative of the property for the purposes of effectuating the security, the trustees must be regarded as the agents of the *cestui que trust* with reference to their rights and interests, both in the title held and in the administration and fruits of the trust, according to its terms and legal operation."

or money expended" under a contract cannot be made to include damages for a breach of the contract.[17] If the property to be charged consists of land, it is of course ineffectual by reason of the statute of frauds, unless it be in writing; but an agreement by word of mouth to charge other property may be enforced in equity by a decree for specific performance.[18]

A failure to observe certain statutory requirements does not prevent a mortgage from being valid, in equity, as against junior judgment creditors. An equitable mortgage is constituted by a valid agreement in writing, made by a business corporation, to give a first mortgage upon its assets for a certain amount and for a specified consideration, to another business corporation, full performance by the latter, a legal obligation to perform by the former, and an attempt to perform.[19]

Statutory liens, as affecting personal property, have, without possession, the same operation and efficacy that existed in common law liens when the possession was delivered.[20]

§ 35. Without a formal mortgage, the bonds of a corporation, providing that they shall be a lien upon the property of the company prior to all others, are in substance a mortgage, and may be enforced in equity as against the corporation and its property.[21] Of course, as against subsequent purchasers and incumbrancers without notice of such lien, whose deeds are first recorded, such bonds would have no priority. Such, for instance, were the bonds of the White Water Valley Company, a corporation organized under the laws of the state of Indiana to build a canal, and whose bonds, pledging "the effects, real and personal," of the company, contained recitals that they should have preference over all debts to be thereafter contracted, and that in default of the payment of interest the holder of the bonds might enter

[17] Waco Tap R. Co. v. Shirley, 45 Tex. 355; 13 Am. Railw. R. 233; and see 1 Jones Mortgages, § 163.

[18] Ashton v. Corrigan, L. R. 13 Eq. 76; Peto v. Brighton &c. R. Co. 1 H. & M. 468.

[19] Hamilton Trust Co. v. Clemens, 163 N. Y. 423, 57 N. E. 614.

[20] Beall v. White, 94 U. S. 382.

[21] Poland v. Lamoille Val. R. Co. 52 Vt. 144, 171. An agreement in notes to give corporate bonds secured by mortgage as soon as legislative permission for this issue is obtained, does not constitute an equitable mortgage, no such consent being obtained. Augusta Trust Co. v. Federal Trust Co. 140 Fed. 930.

into possession of the tolls, water-rates and other incomes of the company, and might apply for the appointment of a receiver. Upon a default occurring, the Supreme Court of the United States held that the bondholders were entitled to this relief, the bonds in effect constituting a mortgage.[22]

Similar illustrations, that informal agreements or instruments are sufficient in equity to create a charge, are furnished by the English courts. Thus, the directors of the Strand Music Hall Company borrowed money under a written agreement that they would deposit with the lender, as collateral security, certain incomplete mortgage bonds, constituting a first charge upon the property. In the winding up of the company a question arose whether these mortgage bonds, by reason of their incompleteness, constituted a valid charge upon the property for this loan. Turner, L. J., delivering the opinion of the court that a valid charge was created, said:[23] "I apprehend that where this court is satisfied that it was intended to create a charge, and that the parties who intended to create it had the power to do so, it will give effect to the intention, notwithstanding any mistake which may have occurred in the attempt to effect it."

A mortgage not executed and recorded according to law, nevertheless has priority of a subsequent mortgage which is expressly made subject to the former.[24]

An informal mortgage executed by a corporation must be treated precisely as if it had been entered into by a natural person, and the corporation cannot take advantage of any informalities which a natural person could not take advantage of under like circumstances.[25]

[22] White Water &c. Co. v. Vallette, 21 How. (U. S.) 414; Howard v. Iron & Land Co. 62 Minn. 298, 64 N. W. 896. In the latter case it is said: "The evident purpose as well as effect of the provision of these debentures is to create a charge in the nature of a floating mortgage, as security for their payment, upon all the property of the company, present or future, but which would in the meantime leave the company at liberty to sell and dispose of any of it in the course of its business, free from the incumbrance of the mortgage, without being required to apply the proceeds to the payment of the mortgage debt." See § 32.

[23] Strand Music Hall Co., In re, 3 De G., J. & S. 147, 158.

[24] Coe v. Columbus &c. R. Co. 10 Ohio St. 372, 75 Am. Dec. 518 n.

[25] Penney v. Lynn, 58 Minn. 371, 59 N. W. 1043.

§ 36. **An agreement of a company to set apart specific earnings or property** in the hands of a third person to meet the interest or principal of its bonds, creates an equitable lien or charge. The legal proposition, which is an accepted doctrine of courts of equity, is tersely stated by Judge Dillon:[26] "If a debtor, by a concluded agreement with a creditor, sets apart a specified amount of a specific fund in the hands, or to come into the hands, of another from a designated source, and directs such person to pay it to the creditor, which he assents to do, this is a specific appropriation, binding upon the parties, and upon all persons with notice who subsequently claim an interest in the fund under the debtor."

§ 37. **An equitable mortgage must have some foundation in contract, or must arise by necessary implication** from the terms or scope of a contract. A provision in a railroad mortgage to trustees made for the purpose of retiring an existing mortgage and prior liens, and of completing and equipping a railroad, that the expenditure of all sums realized from the sale of the bonds secured shall be made with the approval of at least one of the trustees, whose assent in writing shall be necessary to all contracts made by the corporation before the same shall be a charge upon any of the sums received from said sales, does not create a charge in favor of one who has afterwards built a portion of the road under a written contract with the corporation, if the contract did not itself impose such charge. To create a charge upon money which has no earmark would require evidence of the most unmistakable language. It is not enough to create such a charge that the party claiming the lien may, through his efforts or outlays, have added to the security of the bondholders.[27]

A conveyance of a railroad upon the express condition that it is to have effect only upon payment by the purchasing corporation in the

[26] Ketchum v. Pacific R. Co. 4 Dill. (U. S.) 78, 86; affirmed in Ketchum v. St. Louis, 101 U. S. 306, 317, per Harlan, J., quoting text with approval; and see, also, Watson v. Wellington, 1 Russ & Myl. 602; Yeates v. Groves, 1 Ves. Jr. 280; Lett v. Morris, 4 Sim. 607; Alderson, Ex parte, 1 Madd. 53; Legard v. Hodges, 1 Ves. Jr. 478; 3 Bro. C. C. 531; Strand Music Hall Co., In re, 3 De G., J. & S. 147; Pinch v. Anthony, 90 Mass. 536, 5 Am. Dec. 114. See § 93.

[27] Dillon v. Barnard, 1 Holmes (U. S.) 386.

paid-up stock of the company, amounts in equity to a mortgage of the railroad by the purchasing company for the purchase money, and the title remains in the vendor until the condition of the purchase is complied with.[28]

§ 38. A subsequent mortgage may be given priority over a prior mortgage by agreement. Thus, if certain holders of bonds under a prior mortgage, in order to enable the company to raise money to complete its road, sign an agreement that the company may issue new bonds to be denominated preference bonds, which shall be a lien on the property prior to the bonds held by the signers, the agreement operates as an equitable mortgage or pledge of the interest under the first mortgage of those who signed, as security for the payment of the preference bonds; but such agreement will in no way affect the interest or the priority of lien of those who do not sign it.[29]

Where a state, to induce bondholders to furnish money to complete a canal, agrees not only to waive its own lien on revenues, but that the company shall pledge them by mortgage, it cannot insist upon the sale of the canal itself and its franchises clear of the lien of the bondholders on the ground that such lien extends to the revenue only. But although the company is insolvent and the canal in no condition to earn revenue, the state must allow the bondholders to take possession and repair and operate the canal for the purpose of ascertaining whether it can be made to produce any revenue applicable to the payment of their debt.[30]

III. Statutory Liens and Mortgages.

§ 39. A mortgage may be constituted by statute without the execution of any deed of conveyance.[31] In this way the Union Pacific Railroad was mortgaged to the United States to secure the repayment

[28] Tennessee &c. R. v. East Ala. R. Co. 73 Ala. 426.

[29] Poland v. Lamoille &c. R. Co. 52 Vt. 144.

[30] State v. Brown, 73 Md. 484, 21 Atl. 374; Canal Co's Case, 83 Md. 549, 35 Atl. 161, 354, 581.

[31] Wilson v. Boyce, 92 U. S. 320; 2 Dill. (U. S.) 539; Murdock v. Woodson, 2 Dill. (U. S.) 188; Woodson v. Murdock, 22 Wall. (U. S.) 351; Tompkins v. Little Rock &c. R. Co. 15 Fed. 6.

of the amount of bonds of the United States issued and delivered to the company to aid in the construction of the road.[32]

When a statute clearly provides for a lien, it is not essential that the bonds issued by the corporation should themselves recite the words of the act creating the charge, if they show by reference to the act that they were intended to carry the benefit of the lien. An act authorizing a canal company to borrow money on its bonds provided that these should "take precedence and have priority of lien on the said canal and the tolls thereon and other property of the said company over all claims." The bonds issued for the money borrowed by the company stated that the holder was "entitled to such security therefor as is mentioned in the said recited act." The court held that the holders were entitled to a charge upon the canal and tolls as provided by the act, and to the appointment of a receiver.[33]

§ 40. A statutory lien can exist only when the statute in terms not doubtful expresses the intention to give a lien. Thus under a statute giving a city authority to aid a railroad company, and to receive security from the company by mortgage or pledge of stock, the city having accepted security of the latter kind, it can have no statutory lien by reason of a clause of the statute which declares that the above liens, mortgages, or other securities shall have priority of all claims or obligations subsequently contracted by the company.[34]

To constitute a statutory lien, it must clearly appear that it was intended that the statute should have this effect. The Brunswick and Florida Railroad, in 1856, issued its bonds without securing them by mortgage, and subsequently issued other bonds with such security. The holder of the first bonds claimed that under the charter of the company these bonds, *ipso facto,* became a lien upon the property of the company, which was unaffected by the subsequent mortgage. The charter upon which this claim was based provided that "it should be lawful for the board of directors to direct the president and secretary to issue bonds of said company, which shall be binding on the property of said company, and on such other property belonging to the stockholders as they may pledge to said company, by mortgage, to

[32] Act of July 1, 1862, 12 Stat. at Large, 489; and see United States v. Union Pacific R. Co. 91 U. S. 72.

[33] Dundas v. Desjardins Canal Co. 17 Grant (Upper Can. Ch.) 27.

[34] Cincinnati v. Morgan, 3 Wall. (U. S.) 275.

meet their own engagements or the engagements of the company." The court, however, held that these words did not give a statutory lien upon the company's property which was superior or equal to the lien of the subsequent mortgage.[35] The case of *Collins* v. *Central Bank of Georgia*[36] was discussed and considered at length in this connection. The Monroe Railroad and Banking Company was authorized to do a banking business and to issue bills for circulation, and the act provided that the "railroad to be built by said company, together with all the revenues arising therefrom, and all the property, equipments, and effects therewith connected, should be pledged and bound for the redemption of the same." The company having suspended payment, and being unable to complete its road, arranged with contractors to do this under a written agreement that they should have a lien upon the entire road. Upon a subsequent sale of the road under a creditor's bill, the court held, with reference to the distribution of the proceeds, that under the charter the bill-holders had a lien in preference to the contractors as to all that portion of the road built by the company prior to the agreement with the contractors, and that the latter had a prior lien only upon the part they built. This case is distinguished from the case above noticed chiefly by the different nature and character of the debts in the two cases; the one being an ordinary debt for a loan of money, and the other a debt to bill-holders issued under authority of the state for circulation among the people, and having, upon grounds of public policy, a claim to protection. Besides, the language regarding the lien was considered stronger in the case of the banking company than in the case of the railroad; and in the latter case it was regarded as only a fair construction of the whole provision, that, while certain property of the stockholders mortgaged to the company was to be capable of being charged with this debt, it was not intended to discharge the company itself and its property. In other words, the intent to create a lien upon the company's property was not manifested with certainty enough to establish it.

§ 41. A statutory mortgage is construed in the same manner as one executed by deed, as regards the property it embraces. Thus, the state of Missouri having issued bonds in aid of the Cairo and Fulton Railroad Company, under an act which declared that they

[35] Brunswick & Albany R. Co. v. Hughes, 52 Ga. 557.

[36] 1 Kelly (Ga.) 435.

should "constitute a first lien and mortgage upon the road and property" of the company, it was held by the Supreme Court of the United States that a valid lien was created by the act upon all the lands of the company, including such as did not constitute the road, or any part of it, and were not used in connection with it.[37] The generality of the language is no objection to the validity of the mortgage. It is, moreover, as competent for a railroad company to mortgage the lands it has received from the state in aid of its construction as it is to mortgage the lands used for its track or appurtenant to it. The word "property" is broad enough to cover the outside lands of the company, and the legislature must be regarded as having intended, in using this word, to cover all the corporate property of the company of every nature and wherever situated; and such was the construction given to this language by the Supreme Court of Missouri.[38]

If the terms of the statute are broad enough, the lien will extend to the entire road, its franchises, and property then belonging to it or afterwards to be acquired, if the statute so provides; and it is immaterial that the indorsement by the state, for which the lien is given, was not authorized until certain sections of the road were finished and completed.[39]

§ 42. **A statutory mortgage by a railroad company, like a mortgage created by deed, may embrace after-acquired land** and other property acquired after the creation of the lien, if the intention to embrace such land be manifest in the act creating the lien.[40] A statutory mortgage in favor of the state of Missouri, making all bonds issued by the state in aid of certain railroad companies a first lien upon the road and property of the several companies securing them, was held to embrace after-acquired lands, although outside the railroad and not necessary to its use. The term "road and property" is broad enough to cover by the lien of the state all the corporate property of the companies named in the act, and clearly shows an intention to cover all their property.[41] A subsequent foreclosure and sale of the

[37] Wilson v. Boyce, 92 U. S. 320, affirming 2 Dill. (U. S.) 539.

[38] Whitehead v. Vineyard, 50 Mo. 30.

[39] Colt v. Barnes, 64 Ala. 108.

[40] Whitehead v. Vineyard, 50 Mo. 30; Colt v. Barnes, 64 Ala. 108; Tompkins v. Little Rock &c. R. Co. 15 Fed. 6.

[41] Whitehead v. Vineyard, 50 Mo. 30.

road and its property under such act carries the title to such land, although the company has in the meantime conveyed it to a purchaser. A purchaser from the company subsequent to the mortgage can acquire a clear title only through a release of the lien, or by virtue of a statute authorizing sales by the company discharged of the lien in favor of the state.

§ 43. **A state by act of its legislature may release a statutory lien in its favor,** unless restrained by its constitution. In 1868 the state of Missouri, holding a statutory lien upon the Pacific Railroad of Missouri, as indemnity for bonds issued in aid of that company to the aggregate of $7,000,000, passed an act by which, in consideration of $5,000,000, the state would release and discharge the lien. This amount was paid to the state by the railroad company, and the release was made; and on the faith of this release the company mortgaged its road and sold its bonds with the intention of giving a first mortgage lien. The state had previously provided in its constitution that, in the event of any default in the payment of bonds issued by the state in aid of railroad companies, the general assembly should provide by law for the sale of the road and franchises of the company thus making default, under the lien reserved to the state; but that the general assembly should have no power, for any purpose whatever, to release the lien held by the state upon any railroad. In 1873 the legislature of the state directed the governor and attorney general of the state to foreclose the mortgage which had been released, upon the ground that the release was illegal. The trustees of the mortgage subsequently made application to the Circuit Court of the United States for an injunction restraining this sale, which was granted.[42]

The state was not disabled from releasing its security on receiving full value for it, and of its value it was left by the constitution to be the judge,—so left because there was nothing to restrain it.

If the waiver of a statutory lien be made for the purpose of promoting the consolidation of two railroad companies, the waiver will take effect only upon the completion of such consolidation.[43]

[42] Murdock v. Woodson, 2 Dill. (U. S.) 188; affirmed by the Supreme Court of the U. S. on appeal, Woodson v. Murdock, 22 Wall. (U. S.) 351. See, also, Darby v. Wright, 3 Blatchf. (U. S.) 170.

[43] Gibbes v. Greenville &c. R. Co. 13 S. Car. 228.

§ 44. **Not only may a statutory lien be waived, but another person may be substituted by agreement of parties** in place of the original lien-holder. This proposition is illustrated in another phase of the statutory lien last mentioned.[44] Prior to the release by the state of Missouri of the lien in its favor, and the making of the mortgage referred to, the county of St. Louis, under legislative authority, had loaned its bonds to the railroad company to the amount of $700,000, to enable it to complete the road. The county was secured by a provision of the act authorizing the loan, that the person who should be in custody of the earnings of the road, in behalf of the state, should pay into the county treasury out of such earnings a sum sufficient to meet the interest on the bonds. The effect of this provision, when acted upon, was, that the state, then having a complete and perfect lien upon all the earnings of the road, waived it to this extent in favor of the county, and the county was *pro tanto* substituted in its place. This lien of the county was recognized in the subsequent legislation under which the state released its lien. The company having afterwards made a second and third mortgage, a foreclosure sale was made under the latter, the holders of which claimed that the county was not entitled to any charge or lien upon the proceeds. The court, however, established the lien, upon the ground that the effect of the act, and the acceptance of it by the county and the company, was to convert its provisions into a contract which created a lien, having its origin by statute, and equitable in its nature, and of which the subsequent mortgagees had notice through the statutes creating and recognizing it.

IV. Who may execute a Corporate Mortgage.

§ 45. **The directors of a railway or other business corporation,** in the absence of any restriction in its charter or by-laws, may exercise all the authority of the corporation itself in pledging its real or personal property to secure any debts which it is authorized to contract.[45] Being the agents of the corporation rather than the corporate

[44] Ketchum v. Pacific R. Co. 4 Dill. (U. S.) 78; affirmed in Ketchum v. St. Louis, 101 U. S. 306.

[45] 1 Jones Mortgages, §§ 124–128; Hendee v. Pinkerton, 96 Mass. 381, per Foster, J.; McCurdy's Appeal, 65 Pa. St. 290; Bank of Middlebury v. Rutland &c. R. Co. 30 Vt. 159, 169;

body, they may exercise their powers beyond the state by whose laws the corporation was created, unless forbidden by their charter or by the laws of the state; and therefore directors of a Vermont corporation may grant a valid mortgage at a meeting held in Massachusetts.[46] When a corporation has by law the power to execute a mortgage of its franchises and property, a mortgage executed by authority of the directors alone is valid.[47] Any doubt of the validity of such a mortgage is removed by acts of the corporation in ratification of it, such as the issuing of bonds under it and the payment of interest upon it.[48]

It is a sufficient consideration for upholding a mortgage that it was made in conformity with a binding resolution of the board of directors to secure the payment of the company's bonds, so that they might be more advantageously disposed of in the market.[49]

Under a statute which authorizes a railroad company to mortgage its franchises and property with the concurrence of the holders of

Wood v. Whelen, 93 Ill. 153; Hodder v. Ky. &c. R. Co. 7 Fed. 793; Hutchison v. Rockhill R. E. & L. Co. 65 S. Car. 45, 43 S. E. 295.

[46] Arms v. Conant, 36 Vt. 744; Thompson v. Natchez Water Co. 68 Miss. 423, 9 So. 821; Wright v. Lee, 2 S. Dak. 596, 51 N. W. 706; and see Galveston R. v. Cowdrey, 11 Wall. (U. S.) 459; Ohio &c. R. Co. v. McPherson, 35 Mo. 13, 86 Am. Dec. 128; Wright v. Bundy, 11 Ind. 398, 404; McCall v. Byram Mfg. Co. 6 Conn. 428; Bassett v. Monte Christo M. Co. 15 Nev. 293; Coe v. New Jersey &c. R. Co. 31 N. J. Eq. 105. A statute requiring a meeting of directors held out the state to be authorized by two-thirds vote of stockholders must be complied with or the mortgage will be void. State Nat. Bank v. Union Nat. Bank, 168 Ill. 519, 68 Ill. App. 25. To same effect see Union Nat. Bank v. State Nat. Bank, 155 Mo. 95, 55 S. W. 989, 78 A. S. R. 560, holding the rule applied to an Illinois corporation organized to do business in Missouri.

The mortgage may be legally acknowledged by the president or other officer authorized to execute it out of the state. Hodder v. Kentucky &c. R. Co. 7 Fed. 793.

A statute which provides that a corporation shall not mortgage its real estate, or give a lease for more than a year, unless authorized by a vote of the stockholders at a meeting called for the purpose, does not refer to a foreign corporation which may execute a valid mortgage by authority of the directors, who are under a by-law authorized to manage the business of the corporation. Saltmarsh v. Spaulding, 147 Mass. 224, 17 N. E. 316.

[47] McCurdy's Appeal, 65 Pa. St. 290.

[48] McCurdy's Appeal, 65 Pa. St. 290; Hoyt v. Shelden, 3 Bosw. (N. Y.) 267.

[49] Butler v. Rahm, 46 Md. 541.

two-thirds in amount of the stock of the corporation, to be expressed at a meeting of stockholders to be called by the directors, a resolution of the directors at a directors' meeting, authorizing the execution of a mortgage, is a substantial compliance with the statute, in case the directors are the only stockholders except one, and that this one afterwards assented to the mortgage.[50]

Under a statute providing for the voluntary dissolution of corporations by the action of stockholders, directors have not authority to make an assignment for the benefit of creditors. Directors are merely agents, while the value of a business and the advisability of continuing it are matters which concern those who have embarked in it and not their managing agents. But it is the duty of a corporation to pay its debts and directors are justified in using the corporate assets for this purpose.[51]

§ 45a. **Formal action by the board of directors may be rendered unnecessary by the action of stockholders,** as where the directors refer the question of making a mortgage to the stockholders and call a meeting at which the stockholders vote in favor of a mortgage by a large majority. The validity of the mortgage cannot be challenged on the ground that it is not authorized by the board of directors, no formal vote of the board directing a mortgage to be made being necessary in such a case.[52] If all the stockholders of a corporation may ratify an unauthorized act of one of its officers, it seems reasonably clear, on principle, to be within their power to authorize the act in the first instance and without formal or other action on the part of the board of directors.[53]

§ 45b. **Proof of directors' vote authorizing mortgage.**—A recital in a railroad mortgage securing an issue of bonds that it is made in pursuance of a resolution of the board of directors, which resolution is copied in the mortgage, is sufficient to establish *prima facie* the authority required.[54] The fact that the signatures of the officers are

[50] Thomas v. Citizens' &c. R. Co. 104 Ill. 462. See also Franklin Trust Co. v. Rutherford &c. Elec. Co. 57 N. J. Eq. 42, 41 Atl. 488.

[51] Kyle v. Wagner, 45 W. Va. 349, 32 S. E. 213.

[52] Reed v. Helois Carbide Specialty Co. 64 N. J. Eq. 231, 53 Atl. 1057.

[53] Africa v. Duluth News Tribune Co. 82 Minn. 283, 84 N. W. 1019, 83 Am. St. 424.

[54] Hayden v. Lincoln &c. R. Co. 43 Neb. 680, 62 N. W. 73.

attached to the mortgage with the corporate seal is *prima facie* evidence that the mortgage is executed by authority of the company, and the burden of proving want of authority is upon an intervenor.[55] The accuracy and authenticity of minutes of corporation meetings are matters to be determined in deciding whether a mortgage is authorized by the directors, but negative testimony of the directors carries little weight in disproving a written record.[56]

The vote of directors authorizing the execution of a corporate mortgage may be proved by oral testimony when it has never been entered on the records of the corporation, such oral proof not being excluded by a provision requiring a record to be kept of all proceedings transacted by the board of directors.[57]

§ 45c. That the president of a business corporation, though the active manager of its affairs, does not derive power to mortgage its lands or other property by implication from the ordinary duties of his office has been declared to be settled law.[58] In the absence of a by-law or a general usage conferring such power upon the president as an incident to the corporation business, a previous order from the directors or their subsequent ratification, express or implied, is necessary to give the mortgage validity.[59]

The president or general manager of an insolvent corporation has no power without express authority to transfer property of the corporation to secure an existing indebtedness, although a by-law of the corporation provides that he shall have entire charge of the business, subject to the order of the board of directors. Such a transfer is not in the ordinary course of business and is beyond the scope of his general duties.[60] The general power of the manager of a corporation to buy

[55] Gorder v. Plattsmouth &c. Co. 36 Neb. 548, 54 N. W. 830; Brownell & Wright Car Co. v. Barnard, 116 Mo. 667, 22 S. W. 503.

[56] Augusta T. & G. R. Co. v. Kittel, 52 Fed. 63.

[57] Boggs v. Agricultural Park Ass'n, 111 Cal. 354, 43 Pac. 1106; Garmany v. Lawton, 124 Ga. 876, 53 S. E. 669.

[58] Stokes v. New Jersey Pottery Co. 46 N. J. L. 237; Currie v. Bowman, 25 Or. 364, 35 Pac. 848; Brown v. Farmers' Supply Co. 23 Or. 541, 32 Pac. 548; Lewis v. Hartford &c. Mfg. Co. 56 Conn. 25, 12 Atl. 637; State v. Perkins, 90 Mo. App. 603.

[59] Bennett v. Keen, 59 N. J. Eq. 634, 43 Atl. 1070.

[60] Hadden v. Linville, 86 Md. 210, 38 Atl. 37, 900. A stranger claiming under a void tax deed cannot question the authority under which a corporate mortgage is issued. Col-

and sell for the company does not give him implied power to mortgage its property, an agent's power to mortgage not being included in a power to sell.[61]

But where all the shareholders of a corporation by their direct act or acquiescence invest the executive officers with the powers and functions of the board of directors as a permanent arrangement, a mortgage of corporate property executed by such officers is held valid against the corporation or a creditor although it may not have been authorized by a formal vote.[62] And previous authority or ratification will be presumed when the money obtained on the mortgage is used in paying the debts and conducting the business of the corporation.[63]

A mortgage executed by the president and secretary of a corporation with the consent of all the stockholders has been held valid, though there was no vote of the board of directors.[64]

The president of a corporation has no implied power to execute a general assignment of corporate property for the benefit of creditors, and unless he has express authority his acts in making an assignment are void.[65]

§ 45d. **Furthermore, the officers of a corporation must follow the terms of the directors' vote** in executing the mortgage, and if they fail to do so the mortgage is unauthorized. Where directors voted to raise $20,000 by mortgage and authorized a payment of ten per cent. commission for negotiating the loan, and the officers executed a mortgage for that amount to an existing creditor, who only advanced $2,000 in cash, it was held that such mortgage was without authorization from the directors. Their intention had evidently been to secure a fresh loan by means of the mortgage.[66] So a power to an officer to

lins v. Rea, 127 Mich. 273, 86 N. W. 811.

[61] Trent v. Sherlock, 24 Mont. 255, 61 Pac. 650; Trent v. Sherlock, 26 Mont. 85, 66 Pac. 700. But see Thayer v. Nehalem Mill Co. 31 Or. 431, 51 Pac. 202, holding *contra*.

[62] Garmany v. Lawton, 124 Ga. 876, 53 S. E. 669; Bell & Coggeshall Co. v. Kentucky &c. Co. 106 Ky. 7, 50 S. W. 2, 1092, 51 S. W. 180; Sherman v. Fitch, 98 Mass. 59. See Witter v. Grand Rapids F. Mill Co. 78 Wis. 543, 47 N. W. 728, where the officer executing the mortgage owned all but one share of stock.

[63] Edelhoff v. Horner-Miller Mfg. Co. 86 Md. 595, 39 Atl. 314.

[64] Kalamazoo S. & A. Co. v. Winans, 106 Mich. 193, 64 N. W. 23.

[65] Schaefer v. Scott, 40 App. Div. (N. Y.) 438, 57 N. Y. S. 1035.

[66] Miller v. Gourley, 65 N. J. Eq. 237.

mortgage only enables him to execute a mortgage with the usual provisions, and a mortgage giving a power of sale after ten days' advertisement and the right to seize and sell a stock of goods through clerks, was unauthorized, and, being in favor of a director who is bound by notice of the actual authority, invalid.[67]

Provisions in a chattel mortgage relating to insurance and authorizing the mortgagee to take possession and foreclose in case the property is attached need not, however, be specially enumerated in the resolution authorizing the execution of the mortgage. Such stipulations are ordinary provisions in a chattel mortgage, and the authority to execute a mortgage includes authority to insert all ordinary provisions.[68]

A vote of directors authorizing a mortgage is not waived by a subsequent resolution to increase the capital stock. The resolution to formulate a plan for the future action of the company was an effort to raise money to continue the business and, failing that, the mortgage was to be placed on the property.[69]

§ 45e. **As a general rule, equity will not enjoin the exercise of the discretion of a board of directors** in putting out an issue of bonds.[70] However, when the purpose for which the mortgage and bonds are to be issued is prohibited by statute, such issue will be enjoined at the suit of a stockholder.[71]

§ 46. **A power to an officer or agent of a corporation to borrow money on its behalf includes authority to pledge its bonds,** or to give other ordinary securities for the money borrowed. The Minnesota and Pacific Railroad Company authorized its president to borrow such sums, for such length of time and at such rate of interest, as he might think proper, and to purchase iron rails, locomotives and machinery on such terms as he might deem advisable; and in order to do so, to make, execute and deliver obligations, bills of exchange, contracts

[67] Monroe Merc. Co. v. Arnold, 108 Ga. 449, 34 S. E. 176. To the same effect see Gribble v. Columbus Brewing Co., 100 Cal. 67, 34 Pac. 527.

[68] Vincent v. Snoqualmie Mill Co. 7 Wash. 566, 35 Pac. 396.

[69] Lucas v. Friant, 111 Mich. 426, 69 N. W. 735.

[70] Coquard v. Nat. Linseed Oil Co. 171 Ill. 480, 49 N. E. 563, 67 Ill. App. 20.

[71] American I. & I. Co. v. Crane, 142 Ala. 620, 39 So. 233.

and agreements of the company. The president accordingly made a contract in New York for a purchase of railroad iron, and an advance of $16,000 to the company on its notes, and for the security of this contract pledged $45,000 of bonds of the state of Minnesota belonging to the company. The Supreme Court of the United States held that he was clearly authorized to pledge the bonds. He was empowered to make actual purchases, and to borrow money, not merely to make executory contracts for future purchases and loans. To give collateral security for these undertakings was within the limits of such a power.[72]

The president of a railway corporation having authority by a by-law to act as business and financial agent of the corporation cannot bind it by a mortgage of personal property, even such as a locomotive, given to secure a debt of the corporation.[73] His authority in such case is confined to the ordinary business of the corporation. The fact that he affixes to the instrument the corporate seal adds nothing to the validity of the instrument. That does not make the instrument the deed of the company, unless it was affixed by authority. The seal bears upon its face the presumption that the instrument was executed by competent authority from the corporation; but this presumption may be repelled by showing that the seal was affixed without authority.[74] In general, it may be said that when a transfer of corporate property requires the use of the common seal, it cannot be made without the assent and authority of the board of directors. The mere fact, however, that no vote of the directors authorizing the act can be shown is not sufficient to overcome the presumption of authority which arises from the use of the seal; for its use may have been with the tacit assent of the directors.[75]

§ 47. As regards the execution of a corporate mortgage, if the deed purports to be the deed of the corporation, the fact that it is not signed by the corporate name, but by an officer having the power

[72] Hatch v. Coddington, 95 U. S. 48.

[73] Luse v. Isthmus &c. R. Co. 6 Ore. 125, 25 Am. Rep. 506; Hoyt v. Thompson, 5 N. Y. 320, 335; Whitwell v. Warner, 20 Vt. 425; Despatch Line &c. v. Bellamy Mfg. Co. 12 N. H. 205, 37 Am. Dec. 203.

[74] Wood v. Whelen, 93 Ill. 153; Fidelity Ins. Co. v. Shenandoah &c. R. Co. 32 W. Va. 244, 9 S. E. 180.

[75] Union Gold &c. Co. v. Bank, 2 Colo. 226.

to execute the deed in behalf of the company, in his individual name, does not invalidate it as the deed of the corporation.[76] But if the deed purports to be the deed of the officer, and is signed by him in that manner, it is not the deed of the corporation.[77]

A mortgage deed duly executed by the officers of a corporation is the act of the corporation alone, and not that of the officers by whose agency it was executed, and it does not operate to estop such officers from setting up a prior right to the property under a prior lien.[78]

Where there is ambiguity on the face of a note signed by the president of a railroad company in his individual name, without addition, acknowledging indebtedness for labor performed on land of the company, parol evidence is admissible to ascertain whether the note be his own obligation or that of the company.[79]

A trust deed is defectively executed and not entitled to record when

[76] Haven v. Adams, 86 Mass. 80. The mortgage in this case was executed in these words: "In testimony whereof, said party of the first part have caused these presents to be signed by their president, and their common seal to be hereto affixed. A. B., President," and seal. And see Despatch Line &c. v. Bellamy Mfg. Co. 12 N. H. 205, 37 Am. Dec. 203; Savannah & M. R. Co. v. Lancaster, 62 Ala. 555. The form of execution may be prescribed by statute. Wisconsin: R. S. 1878, § 2216; Galloway v. Hamilton, 68 Wis. 651, 32 N. W. 636. In Maine, as to effect of statute in such case, see Porter v. Androscoggin &c. R. Co. 37 Me. 349. See 1 Jones Mortgages, § 130.

Recovery may be had upon coupons of bonds signed by the vice-president of a company, although the mortgage accompanying the bonds provides that the bonds should be signed by the president. Conshohocken Tube Co. v. Iron Car Equipment Co. 161 Penn. St. 391, 28 Atl. 1119.

[77] Brinley v. Mann, 56 Mass. 337. In this case the words were: "In witness whereof I (the treasurer), in behalf of said company, and as their treasurer, have hereunto set my hand and seal. A. B., Treasurer," &c., and seal. Where the wording of a chattel mortgage is "I do" convey and "if I fail" to pay, an attorney fee may be charged to "me," and the attestation was "witness my hand and seal" and the president signs his own name followed by the abbreviation "Pres.," it is a mortgage by the president personally and not by the corporation. Clark v. Hodge, 116 N. C. 7612, 21 S. E. 562. See, also, Miller v. Rutland &c. R. Co. 36 Vt. 452.

[78] Traders' Nat Bank v. Mfg. Co. 100 N. C. 345, 5 S. E. 81; 96 N. C., 3 S. E. 363.

[79] Richmond &c. R. Co. v. Snead, 19 Gratt. (Va.) 354, 100 Am. Dec. 670. A note signed "A. B., President" and "A. B., Personally" was held to be the note of the corporation. McCormick v. Stockton &c. R. Co. 130 Cal. 100, 62 Pac. 267.

there is no subscribing witness as required by statute and the acknowledgment is by the president alone, the acknowledgment of the secretary being also necessary as one of the parties authorized to execute the deed and as the party having custody of the corporate seal. Though not a legal mortgage, it will nevertheless be regarded as an equitable lien which will be enforced by special proceedings in equity.[80]

§ 48. **The mere fact that a mortgage deed has the seal of a corporation attached does not make it the deed of the corporation,** unless the seal was placed upon it by some one duly authorized. The seal being affixed to the deed, there is a presumption that it was rightfully affixed; but this presumption may be overthrown by parol evidence to the contrary.[81] When it is shown that the officers who executed the mortgage did not seal it then or afterward; that the officer who had the seal in custody never affixed it, nor authorized any one else to do so; and that the instrument was recorded without a seal, the burden is thrown upon the mortgagee to prove that it was properly sealed. Otherwise the conclusion will be drawn that the seal was fraudulently abstracted from the lawful custodian of it, and wrongfully affixed to the mortgage.[82]

A vote of the directors of a corporation instructing their president and secretary to execute a mortgage to secure a specific debt, does not authorize these officers to insert in the mortgage an unusual provision, such as a contract to pay the mortgagee an attorney's fee in case legal proceedings are taken to enforce the mortgage. A subsequent ratification of the mortgage by the directors, without any knowledge of its contents except as indicated in the original vote for its execution, is not a ratification of this provision for an attorney's fee. Though the directors are presumed to know what is shown in the records of the

[80] Frank v. Hicks, 4 Wyo. 502, 35 Pac. 475, 1025.

[81] Fidelity Ins. Co. v. Shenandoah &c. R. Co. 32 W. Va. 244, 9 S. E. 180; Northern &c. R. Co. v. Bastian, 15 Md. 494. Failure to affix the corporate seal has been held not to render a corporation mortgage invalid, the old rule in regard to contracts by corporations being modified by recent decisions. First Nat. Bank v. G. V. B. Min. Co. 89 Fed. 439; Thayer v. Nehalem Mill Co. 31 Or. 437, 51 Pac. 202.

[82] Koehler v. Black River &c. Co. 2 Black (U. S.) 715; and see Reed v. Bradley, 17 Ill. 321.

company, they are not presumed to know of an unauthorized provision in a mortgage executed by the president and secretary.[83]

§ 49. Ratification.—The execution of a mortgage or promissory note by the officers of a corporation, without previous authority, may be expressly ratified by a vote of the stockholders,[84] or a ratification of it may be implied from their acts.[85] Thus it may be impliedly ratified and confirmed by the payment of interest upon the bonds, and by other acts showing a clear recognition of the mortgage by the corporation.[86]

The receiving and retaining of money advanced by bondholders upon a mortgage amount to a ratification of the contract under which the money was obtained,[87] and it does not matter that the resolution authorizing the giving of the mortgage did not give the president and

[83] Pacific Rolling Mill v. Dayton &c. R. Co. 5 Fed. 852.

[84] Crossette v. Jordan, 132 Mich. 78, 92 N. W. 782.

[85] Proxies for a vote upon ratification should specify not only the bonds, but the mortgage securing them. Marie v. Garrison, 13 Abb. N. C. (N. Y.) 210.

Under a statute forbidding religious corporations to borrow except by vote of their members, notes executed by trustees without a vote were ratified by the acts of the corporation in receiving and using the money thereby obtained. Illinois Conference v. Plagge, 177 Ill. 431, 53 N. E. 76, 69 A. S. R. 252, 76 App. Ill. 468.

Ratification may be proved by a certified copy of a resolution of the board of directors. Purser v. Eagle Lake L. & I. Co. 111 Cal. 139, 43 Pac. 523.

A general resolution of directors authorizing officers to execute mortgages acts as a ratification of previous mortgages executed by the officers of which the directors had knowledge. Shaver v. Harding, 82 Iowa 378, 47 N. W. 1004. The president of a corporation having power to execute a mortgage may ratify one. Trent v. Shelock, 26 Mont. 85, 66 Pac. 700.

[86] McCurdy's Appeal, 65 Pa. St. 290; Wood v. Whelen, 93 Ill. 153; Harrison v. Annapolis &c. R. Co. 50 Md. 490; Singer v. St. Louis R. Co. 6 Mo. App. 427; Fidelity Ins. Co. v. Shenandoah &c. R. Co. (W. Va.), 9 S. E. 180; Trader v. Jarvis, 23 W. Va. 100, 108.

[87] Lewis v. Hartford &c. Mfg. Co. 56 Conn. 25; Ottawa &c. Road Co. v. Murray, 15 Ill. 336; Aurora &c. Society v. Paddock, 80 Ill. 263; Thomas v. Citizens &c. R. Co. 104 Ill. 462; Mills v. Boyle Min. Co. 132 Cal. 95, 64 Pac. 122; Gribble v. Columbus Brewing Co. 100 Cal. 67, 34 Pac. 527; Murray v. Beal, 23 Utah 548, 65 Pac. 726; Kirwin v. Washington Match Co. 37 Wash. St. 285, 79 Pac. 928; Seal v. Puget Sound Loan &c. Co. 5 Wash. 422, 32 Pac. 214.

secretary authority to make so extensive a mortgage as that which was in fact executed.[88] In like manner, if the president and secretary of a railway company execute a mortgage in broader terms than they were authorized by the resolution of the directors to make the mortgage, and money is advanced in good faith upon the bonds, and is received and used by the company in constructing its road, this will be deemed a ratification of the contract under which the money was advanced.[89]

Even where a statute provides that no railroad mortgage shall be valid unless authorized by resolution adopted by a vote of two-thirds of all the stock, the corporation is estopped from denying the validity of a mortgage not so authorized, after it has received the benefit of the mortgage.[90]

Under a statute which provides that a majority of the stockholders at any legal meeting is requisite for the valid transaction of any business, except that the board of directors shall not be empowered to mortgage or hypothecate the property of the company unless by a vote of two-thirds in interest of the stockholders, while it is competent for a majority to ratify the execution of a promissory note of the company, it requires a two-thirds vote to ratify the execution of a mortgage given to secure such note. Therefore a subsequent resolution, adopted by a majority of the stockholders, to levy an assessment for the express purpose of liquidating the note, would be a distinct recognition of it, and equivalent to a previous authority to execute it. But the mortgage stands upon a different footing. It cannot be ratified by a less number of stockholders than was required for its execution. The assessment being valid, the stockholders had no option but to

[88] Elwell v. Grand St. &c. R. Co. 67 Barb. (N. Y.) 83.

[89] Elwell v. Grand St. &c. R. Co. 67 Barb. (N. Y.) 83. See also Page v. Fall River W. &c. R. Co. 31 Fed. 257; Lester v. Webb, 1 Allen (Mass.) 34; Merchants' Bank v. State Bank, 10 Wall. (U. S.) 604; Mining Co. v. Anglo-Californian Bank, 104 U. S. 192.

[90] Texas &c. R. Co. v. Gentry, 69 Tex. 625, 8 S. W. 98; and see National Bank v. Matthews, 98 U. S. 621; Railway Co. v. McCarthy, 96 U. S. 258; Whitney Arms Co. v. Barlow, 63 N. Y. 62, 20 Am. R. 504; Perkins v. Portland &c. R. Co. 47 Me. 573, 74 Am. Dec. 507; City F. Insurance Co. v. Carrugi, 41 Ga. 660; So. Insurance &c. Co. v. Lanier, 5 Fla. 110, 58 Am. Dec. 448; Hays v. Gas Light & C. Co. 29 Ohio St. 330; Foulke v. San Diego &c. R. Co. 51 Cal. 365; Darst v. Gale, 83 Ill. 136; Thompson v. Lambert, 44 Iowa 239.

pay it, and their understanding that the money was to be applied to the payment of the note does not show that they admitted the validity of the mortgage.[91] The subsequent assent of two-thirds of the number of stockholders by any instrument in writing which ratifies the mortgage is sufficient. The requirement as to the number of stockholders necessary to authorize a mortgage has reference to the stock actually issued, and not to the nominal amount to which the capital stock is limited.

As against creditors of a corporation, the directors' act of ratification must be as formal as their original authorization is required to be, and directors cannot ratify a mortgage, executed by the president, by mere acquiescence.[92]

§ 49a. **In the absence of knowledge of the note or mortgage by the directors or the stockholders** no ratification by them can be implied.[93] It has been declared that every detail of the transaction must be known prior to ratification.[94] But the ratification of an unauthorized bond issue will be presumed where the corporation has for a considerable time used the illegal bonds under such circumstances as to render it incredible that the facts concerning the original issue are not fully known to the corporation, its officers, directors and stockholders.[95]

[91] Forbes v. San Rafael Tpk. Co. 50 Cal. 340; and see Greenpoint Sugar Co. v. King's County Mfg. Co. 7 Hun (N. Y.) 44.

Where a note and mortgage of a corporation were both invalid because not authorized, the requirements for ratifying them are essentially different. The mortgage can only be ratified in writing, but the execution of the note may be ratified by acts *in pais*. Curtin v. Salmon River &c. Co. 141 Cal. 308, 74 Pac. 851, 99 Atl. R. 75. A corporation has been held to ratify a purchase-money mortgage by retaining possession of the land and selling part of it. Blood v. La Serena L. & W. Co. 134 Cal. 361, 66 Pac. 317. And by retaining possession and paying interest. Lake Street &c. R. Co. v. Carmichael, 184 Ill. 348, 56 N. E. 372, 82 Ill. App. 344; Dexter v. Long, 2 Wash. St. 435, 27 Pac. 271, 26 Am. St. 867. See also in regard to ratification, Relley v. Campbell, 134 Cal. 175, 66 Pac. 220. Ratification at a meeting of directors, of which notice was not given does not bind the corporation. Pauly v. Pauly, 107 Cal. 8, 40 Pac. 29.

[92] State v. Perkins, 90 Mo. App. 103.

[93] First Nat. Bank v. Kirkly, 43 Fla. 376, 32 So. 881; Thompson v. Des Moines Driv. Park, 112 Iowa 628, 84 N. W. 678.

[94] Edwards v. Carson Water Co., 21 Nev. 469, 34 Pac. 381.

[95] Stainback v. Junk Bros. &c. Co. 98 Tenn. 306, 39 S. W. 530.

V. *Construction of Various Provisions of Corporate Mortgages.*

General statement.—Mortgages by railroad companies and other corporations differ so widely in their form and provisions, that it would be of little use to take up the several parts of a corporate mortgage and treat in detail of their construction in the way that the several parts of an ordinary mortgage might be treated of.[96] Without, therefore, attempting anything of this nature, and without attempting to make a systematic examination of the several provisions of railroad and other corporate mortgages, it is proposed in this division of the chapter to state the construction which the courts have placed upon various clauses peculiar to such mortgages.

§ 50. Restrictions or provisions in a statute authorizing a corporation to issue bonds secured by mortgage enter into the contract, and bind the parties to it, although the mortgage itself contains inconsistent provisions. Thus, where a mortgage is made to secure bonds with interest payable semi-annually, under the authority of a statute which declares that the bonds shall not mature at an earlier period than thirty years, a provision in them that, upon a failure to pay any coupon when presented for payment, and a continued default thereon for six months, the whole sum mentioned in the bonds shall become due and payable, is void. In such case, however, the mortgage may properly provide that it shall be foreclosed upon non-payment of interest. When a foreclosure suit is brought in consequence of such default, and the sum ascertained to be due on the coupons is paid within such reasonable time as the court shall appoint,—say ninety days or six months, or before the next term of court,—no further proceedings in the suit can be had until there is another default. If the sum be not so paid, a sale of the property, with a foreclosure of all the rights subordinate to the mortgage, should be ordered, with a direction to bring the proceeds into court. There can be but one decree of foreclosure of the same mortgage on the same property; and it is a necessity of that foreclosure, under the principles of equity, that all the sums secured by the mortgage shall be protected according to their priority of lien. The mortgagee will have a lien on the money thus paid into court, not only for his overdue coupons, but for his princi-

[96] 1 Jones Mortgages, §§ 60–101.

pal debt, and it must be provided for in the order distributing the proceeds of sale.[97]

When authority is given in general terms to an officer or agent of a corporation to execute a mortgage of its property, he has implied authority to execute it in the usual form, and with the usual provisions for mortgages of that kind; but there is no implied authority to execute a mortgage with unusual provisions. Thus, a stipulation that the principal sum secured should become due at the option of the holder, upon default in the payment of the interest, being unusual in mortgages executed in Wisconsin, the supreme court of that state held that under such general authority the agent could not bind the company by such a stipulation. The unauthorized stipulation would not, however, invalidate the mortgage in any other respect.[98]

§ 51. The whole debt may be made to become due upon any default in the payment of interest or of principal.[99] The courts will not interfere to relieve a promisor from payment in accordance with such a stipulation.[101] Thus, it is no defense to a default in accordance with such a stipulation that forgeries of the coupons were put in circulation so executed as not to be distinguished from the genuine, and that all the bondholders except plaintiff had accepted new bonds so prepared as to prevent the possibility of fraud or loss, and that plaintiff, after presenting his coupons and demanding payment, entered into negotiations for the protection of the promisor in case his coupons should after payment prove to be forgeries, and that the ninety days elapsed while these negotiations were pending.[102]

A provision in a railway mortgage that upon any default in the payment of any instalment of the principal or interest, the whole debt shall become due and payable, if not inserted in the bonds secured by the mortgage, may not affect their payment, or enable a bondholder to enforce them by suit at law as becoming due upon a

[97] Howell v. Weston R. Co. 94 U. S. 463.

[98] Jesup v. City Bank of Racine, 14 Wis. 331; 1 Jones Mortgages, § 129.

[99] Howell v. Western R. Co. 94 U. S. 463; Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.) 409, 447; Macon &c. R. Co. v. Georgia R. Co. 63 Ga. 103; Central Trust Co. v. New York City &c. R. Co. 33 Hun (N. Y.) 513; New Memphis Gaslight Co. Cases, 105 Tenn. 268, 60 S. W. 206, 80 A. S. R. 880.

[101] Jones Mortgages, § 1185.

[102] Wood v. Consolidated &c. Light Co. 36 Fed. 538.

default in the payment of interest. In such case the interest clause is not regarded as having been placed in the mortgage to give the several bondholders a right of action upon it for the principal of the bonds, but to give the trustees, with whom the covenant was made in trust for the bondholders, a right of action upon it, so that, through foreclosing the mortgage, it might be a more complete security to the bondholders with such a clause than it would be without it. Such was the conclusion in one case,[103] although upon each of the bonds was a certificate, signed by the trustees, which stated that the said series of bonds was secured by a first mortgage, which contained a provision, "that the principal sum secured by said mortgage shall become due in case the interest on the bonds remains unpaid for four months." A bondholder having brought a suit upon some of the bonds before their maturity, it was held that he could recover only the interest remaining unpaid and represented by the coupons. Aside from the fact that this clause was not inserted in the bonds, reliance was placed by the court upon the fact that in the mortgage this clause was connected with other clauses, which had reference solely to the enforcing of the mortgage security, and immediately following were the words: "And the lien or incumbrance hereby created, for the security thereof, may be at once enforced." The inference was, that the interest clause had reference solely to the enforcement of the security by the trustees.

§ 52. **A mortgagee who does not choose to enforce his mortgage after a default in the payment of interest cannot be compelled to receive payment** of the principal debt before its maturity, except in pursuance of some general law enacted previously to the making of the mortgage, and therefore entering into the substance of the mortgage contract. Though the rate of interest be burdensome, the mortgagor cannot compel a foreclosure and payment of the mortgage debt before its maturity, by refusing to pay the interest according to the terms of the bonds and mortgage. If he fails to pay the interest and appropriates the income to his own use, the mortgagee may take possession in order to secure the appropriation of the income to the payment of the interest.[104] The state of New Jersey provided by

[103] Mallory v. West Shore &c. R. Co. 3 J. & S. (N. Y.) 174. See 1 Jones Mortgages, §§ 76, 1179–1186.

[104] Dow v. Memphis &c. R. Co. 20 Fed. 260; Nebraska City Bank v. Nebraska City Gas Light Co. 4 McCrary (U. S.) 319, 14 Fed. 763.

statute[105] that whenever a railroad company of that state became insolvent, or failed for ninety days after the same became due to pay the principal or interest on any mortgage upon the property and franchises of the company, upon the application of any creditor, mortgagee, or stockholder of the company, the chancellor might appoint a receiver, and authorize him to sell the property and franchises of the company free of all incumbrances, and the money arising from such sale should be paid into court subject to the same liens, to be disposed of as the court might direct. Prior to this statute the New Jersey West Line Railroad Company executed a mortgage to trustees, to secure certain bonds, payable in the year 1900, one of the terms of the mortgage being that, if the principal or interest should not be paid at the time stated, the principal sum secured by the mortgage should become immediately due "at the election of the trustees." Upon the subsequent insolvency of the company, upon the application of creditors, a receiver was appointed, and he was authorized to sell the property free from the lien of the mortgage. The mortgagees resisted this order of sale, and the court of errors and appeals[106] held that, the trustees not having exercised their election to regard the mortgage as due and payable, the property could not be sold free from this lien. The time fixed for payment of a mortgage loan is a material matter, and it cannot be hastened or postponed without altering the contract in point of substance. The mortgagee cannot be compelled by any legislative act subsequently framed to accept payment at an earlier period than the mortgage provides for.

§ 53. **The word "maturity," as applied to the time of payment of bonds** bearing semi-annual interest, was a subject of interpretation in the case of *United States* v. *Union Pacific Railroad Company*,[107] where the question was whether the company was required to pay the interest on the bonds issued by the United States in aid of the company before the maturity of the principal of the bonds. The bonds were issued by the United States under an act of congress,[108] giving a statutory mortgage upon the property of the company for the amount of bonds to be issued, and providing that upon a failure of said com-

[105] Laws 1870 (March 17), ch. 430.

[106] Randolph v. Middleton, 26 N. J. Eq. 543; Middleton v. New Jersey &c. R. Co. 25 N. J. Eq. 306.

[107] 91 U. S. 72.

[108] Act of July 1, 1862; 12 Stats. at Large, p. 489.

pany to redeem the bonds in accordance with the terms of the act, the secretary of the treasury might take possession of the property for the use and benefit of the United States. The act further provided that "the grants aforesaid are made upon condition that said company shall pay said bonds at maturity; * * * and all compensation for services rendered for the government shall be applied to the payment of said bonds and interest until the whole amount is fully paid." By a subsequent act,[109] it was provided that "only one-half of the compensation for services rendered for the government shall be required to be applied to the payment of the bonds issued by the government in aid of the construction of said road." The supreme court of the United States,[110] upon consideration of the act and the purposes con-

[109] July 2, 1864; 13 Stats. at Large 356.

[110] United States v. Union Pacific R. Co. 91 U. S. 72. Mr. Justice Davis, delivering the opinion of the court, said: "If the language used is taken in its natural and obvious sense, there can be no difficulty in arriving at the meaning of the condition 'to pay said bonds at maturity.' As commonly understood, the word 'maturity,' in its application to bonds and other similar instruments, refers to the time fixed for their payment, which is the termination of the period they have to run. The bonds in question were bonds of the United States, promising to pay to the holder of them one thousand dollars thirty years after date, and the interest every six months. This obligation the government was required to perform; and, as the bonds were issued and delivered to the corporation to be sold for the purpose of raising money to construct its road, it is insisted that Congress must have meant to impose a corresponding obligation on the corporation. In support of this construction, it is sought to give to the word 'maturity' a double signification, applying it to each payment of interest as it falls due, as well as to the principal. But this is extending, contrary to all legal rules, the operation of words by a forced construction beyond their real and ordinary meaning. Courts cannot supply omissions in legislation, nor afford relief because they are supposed to exist. * * * The words 'to pay said bonds at maturity' do not bear the sense which is sought to be attributed to them. They evidently imply an obligation to pay both principal and interest when the time fixed for the payment of the principal has arrived, but not to pay the interest as it accrues. It is one to thing to be required to pay principal and interest when the bonds have reached maturity, and a wholly different thing to be required to pay the interest every six months and the principal at the end of thirty years. The obligations are so different that they cannot both grow out of the words employed, and it is necessary to superadd other words, in order to include

templated by it, held that it was not the intention of congress to require the company to pay the interest before the maturity of the principal of the bonds.

§ 54. **The principal may become due before the time named for its payment** under provisions making the principal payable after a specified default in the payment of interest. All conditions and provisions in a clause providing for the forfeiture of credit as to the principal debt should be fulfilled in order to obtain a decree for both principal and interest before the principal is due. Thus, under a mortgage which provides that the trustee, after a default in the payment of interest for a time specified, shall, upon the written request of the holders of a majority of the bonds outstanding, proceed to collect both principal and interest, a decree for the principal of the mortgage is not authorized in case the trustee brings suit without obtaining such written request.[111]

§ 55. **Provisions restricting the forfeiture of credit as to the principal may not restrict a foreclosure suit for the interest** due and unpaid. Thus, a provision that after default for a time specified the principal shall become due, and upon request of a majority of the bondholders the trustees shall foreclose the mortgage, does not restrict a

the payment of semi-annual interest as it falls due. Neither on principle nor authority is such a plain departure from the express letter of the statute warranted, especially when it leads to so great change in the condition annexed to the grant." See also United States v. Kansas Pacific R. Co. 4 Dill (U. S.) 367.

[111] Chicago & V. R. Co. v. Fosdick, 1 S. Ct. 10, 106 U. S. 47. Chief Justice Waite delivered a dissenting opinion, in which Mr. Justice Harlan concurred, that the trustee after a default for the specific time was not precluded from commencing proceedings of his own notion, without obtaining the request of the holders of a majority of the outstanding bonds. "It is possible," he said, "if a majority of the bondholders had, in an appropriate way, interfered to prevent the trustees from going on, some relief might have been afforded them; but when all came in and availed themselves of what had been done, the corporation was in no position to defend, because a request had not been formally made in advance. * * * The provision in the mortgage for the written request was, as it seems to me, not for the protection of the company, but the bondholders. If the bondholders are satisfied with what the trustees have done, the corporation is in no condition to complain."

coupon-holder from maintaining a foreclosure suit for interest upon default without the assent of a majority of the bondholders, if he does not seek to take advantage of the default as advancing the date when the principal becomes due.[112]

§ 56. If there is a difference between the terms of the mortgage and those of the bonds secured as regards a forfeiture of credit through a default in the payment of interest, the terms of the bonds will control, as they are regarded as the principal thing containing the obligation of the company, and the mortgage is a mere security for the performance of that obligation. Thus, where a mortgage provides that upon the non-payment of interest for six months the principal of the bonds shall forthwith become due and payable, and the bonds declare that in case of the non-payment of any half-yearly instalment of interest which shall have become due *and been demanded,* and such default shall have continued six months after demand, the principal shall become due, with the effect provided in the mortgage, it was held that a demand for the payment of the coupons was necessary to make the principal of the bonds payable.[113]

In another case a mortgage securing a bond issue provided that in case of default in the payment of the semi-annual interest at any time for more than six months after demand made, the trustee should foreclose the mortgage by entry or sale upon the written request of the holders of one-third of the amount of outstanding bonds, "it being distinctly understood and agreed that in the event of any such default, the whole principal sum of all of said bonds then outstanding shall forthwith become due and payable." After default in the payment of interest for six months but before the maturity of the bonds, one bondholder brought an action of debt on his bond, but the court sustained a demurrer to the declaration, holding the terms of the mortgage could not be imported into the contract so as to give a present right of action for the principal. The provision for earlier maturity was only for the purposes of foreclosure by entry or sale.[114]

[112] Chicago &c. R. Co. v. Fosdick, 106 U. S. 47, 1 Sup. Ct. 10; Beekman v. Hudson River &c. R. Co. 35 Fed. 3; Shaw v. Railroad Co. 100 U. S. 605, 611; Credit Co. v. Arkansas &c. R. Co. 5 McCrary (U. S.) 23.

[113] Railway Co. v. Sprague, 103 U. S. 756.

[114] American Nat. Bank v. American Wood Paper Co. 19 R. I. 149, 32 Atl. 305. The court argues as follows: "If one-third, in amount, of

§ 57. **A specific demand of payment of the interest due may be necessary to work a forfeiture of credit as to the principal.** Thus, under a condition that the principal is to become due at the option of the bondholder if default in the payment of interest continues for ninety days after payment is demanded, presentment and demand on the second day of January, though premature as to the interest due January first, because the days of grace had not expired, are a due presentment and demand as to the interest maturing on the first day of July previous.[115] A formal demand of payment of the interest implies that the bondholder intends no longer to waive his rights under the agreement, but insists upon the strict fulfilment of the condition. The demand may be made on the day the interest is due, or at any time thereafter. So long as no demand is made, the bondholder is deemed to waive his right to a forfeiture of credit as to the principal debt.

If demand for payment of interest is properly made in writing, it is not sufficient to defeat a foreclosure suit that the interest coupons were not presented at the banking house where they were made payable and offered to be surrendered on payment. An obligation for the payment of money at a specified place creates, not a conditional liability dependent upon presentment and demand of payment at that place, but an absolute liability to pay generally.[116]

§ 58. **A mortgage deed should so fully and accurately describe the bonds to be secured by it,** that their identity may be readily established. But any doubt or ambiguity arising from an imperfect or er-

the bondholders is required for a sale, out of the proceeds of which the principal is to be paid, it would be quite incompatible with this limitation to hold that a single bondholder could precipitate the maturity of the bonds by a suit. When one is due all are due, and the provision implies that the large majority may think it best not to foreclose at once, and, if so, the right to give time is secured in this provision. It is a provision for a special purpose and not intended to give a right of action upon default, independently of foreclosure proceedings. Such is the construction given to similar provisions in Bachelder v. Council Grove Water Co. 131 N. Y. 42, 29 N. E. 801; White v. Miller, 52 Minn. 367, 54 N. W. 736, 19 L. R. A. 673; McClelland v. Bishop, 42 Ohio St. 113; Mallory v. West Shore & H. R. Railroad Co. 35 N. Y. Super. Ct. 174."

[115] Wood v. Consolidated &c. Light Co. 36 Fed. 538.

[116] Security Trust &c. Co. v. New Jersey Paper Board &c. Co. 57 N. J. Eq. 603, 42 Atl. 746.

roneous description may be removed by parol evidence. Thus, bonds of the Worcester and Somerset Railroad Company of Maryland, dated on the first day of October, were held to be embraced in a mortgage deed dated the twenty-fifth day of the same month, inasmuch as the bonds were in other respects clearly described in the deed, and there was nothing in the terms of the deed inconsistent with the fact that they had been before executed, and any uncertainty that existed on the subject had been removed by evidence that no other bonds were executed or issued by the company.[117]

§ 59. Power reserved in mortgage to dispose of property not necessary for the use of the road.—A provision in a mortgage, which by its terms covers the present property of a railroad company and its future acquisitions, its rolling stock, materials, machinery, and all other personal property, that the company may dispose of or pledge property not used or not necessary for the road, provided it should apply all the proceeds to the use and benefit of the road, does not nullify the mortgage as to those articles, and withdraw the lien of the mortgage as fast as such articles, as broken wheels, rails, or ties, or the like, are cast aside. The exercise of this power is regarded as merely incidental, and necessary to the possession and working of the road.[118]

A provision that "nothing herein contained shall prevent the said company, before default in the payment of any of the said bonds, or the interest due thereon, from selling, hypothecating, or otherwise disposing of any of their said property, real or personal, not necessary in their judgment for the use of the said road, nor from collecting and applying any money due to the said company from any source whatever, provided said application shall not be to the prejudice of any holder of any of the said bonds," does not render the mortgage fraud-

[117] Butler v. Rahm, 46 Md. 541. See 1 Jones Mortgages, §§ 343–356.

[118] Coopers v. Wolf, 15 Ohio St. 523, Brinkerhoff, C. J., and Scott, J., dissenting.

Under a mortgage of lands belonging to a railroad company which reserves a right to sell the lands and pay the proceeds of the sales to the mortgage trustees, after deducting expenses incurred in executing the trust, the railroad company may retain not only the expenses incurred in making the sales, but also the taxes upon the lands. Such taxes are a lien and paramount claim, and may be regarded as expenses incurred under the reservation. Nickerson v. Atchison &c. R. Co. 3 McCrary (U. S.) 455, 17 Fed. 408.

ulent and invalid. However suspicious such a power might be in the case of a mortgage of ordinary goods, the very nature of a railroad corporation, its business, the wear and tear of its iron, ties, and rolling stock, the constant necessity of replacing injured or worn-out appurtenances with new, forbids the inference of a fraudulent purpose. The power retained is in the interest of the mortgagees as well as of other creditors of the company, and of the company itself.[119]

Under a provision in articles ratifying the consolidation of two railroad companies, preserving the rights and remedies of the creditors of the old companies, but authorizing the new company to dispose of any property, real or personal, held by either of the original companies, the power of sale is confined to such property as is not needed for operating the road, such as surplus lands, and personal effects not in present use, and not required for the use of the road.[120]

§ 59a. **Power to use assets in extending works construed.**—A deed of trust securing bonds is not vitiated by a stipulation that nothing therein contained shall prevent the maker, a gas light company, from "using or expending its money and assets in extending its works, or from selling or exchanging, when deemed expedient for the increase and benefit of its business, its town lots, buildings, manufactories, and machinery, the security of the bonds not to be lessened thereby," where the personal property of the maker is not embraced in the conveyance. "Assets" as here used embraces only personalty. The power to sell and exchange realty is a limited one and could be made effectual only by consent and conveyance by the trustee and for the purpose of the trust. This construction of the instrument is natural and in accord with the rule to construe instruments so as to give them operative effect rather than to destroy them.[121]

A provision giving the mortgagor power "to have, hold, use, possess and enjoy" the mortgaged property then owned or thereafter acquired and "to receive the income and profits thereof to its own use and benefit" though good between the mortgagor and bondholders is void as against the claims of other creditors of the mortgagor, and the fact that the trustee for the bondholders obtains possession of the proceeds of the mortgaged property before levy or execution by other creditors

[119] Butler v. Rahm, 46 Md. 541.

[120] Spruce v. Mobile & M. R. Co. 79 Ala. 576.

[121] New Memphis &c. Co. Cases, 105 Tenn. 268, 60 S. W. 206, 80 A. S. R. 880.

does not establish an equitable lien in favor of such bondholders, for the trustee is responsible for the vice in the mortgage.[122]

§ 60. Reservation of power to create a prior lien.—The Texas and New Orleans Railroad Company, in 1858, executed a first mortgage of its property with a special reservation, that whenever the company should procure from the state of Texas a loan of six thousand dollars per mile out of the school fund, and should execute its bonds to the state for the same, they should constitute a lien upon the property mortgaged prior and superior to the lien of the above mentioned mortgage. This reservation was made in pursuance of the law of 1856, which entitled the company to this school fund loan, and by which it was expressly provided that the bonds given to the state should constitute a lien upon the road and charter rights of the company, including the roadbed, right of way, and all property owned by the company as necessary for its business; and that they should have a priority over all other claims against the company. Early in 1861 forty miles of the road remained still unfinished and the resources of the company were exhausted. The school fund loan for this portion of the line, on which the company had relied, was essential to enable it to complete the work, but the state could not advance any more school fund bonds, or at least did not. In this situation of affairs an act was passed[123] entitled "An act for the relief of the Texas and New Orleans Railroad Company," by which it was provided, among other things, that the company might issue a first mortgage upon this uncompleted portion of its road to the amount of $6,000 per mile, which should be a prior lien to the mortgage of 1868 provided the company would relinquish all claims to the state loan for that portion of the road. The mortgage was executed accordingly. The question afterward arose whether the mortgage of 1858 or the mortgage of 1861 should have priority; the holders of the bonds of 1858 contending that, although the company might have given such a lien to the state upon borrowing money of it, yet that it had relinquished this right, and therefore that these bonds and the mortgage thus became the first lien on the road and its appurtenances. But the court held otherwise.[124] The bonds authorized by this legislation were issued for full

[122] Zartman v. First Nat. Bank, 109 App. Div. (N. Y.) 406, 96 N. Y. S. 633, 16 Am. Bank. R. 152.

[123] Act of Feb. 7, 1871.

[124] Campbell v. Texas &c. R. Co. 2 Woods (U. S.) 263.

value to parties who received them in good faith as a first lien upon that portion of the road; and the court held that they were entitled to stand in the place of the state and have a first lien on such road.

Objection was made that the substituted bonds varied from those which the state was to give under the reservation contained in the first mortgage, and therefore that they could not be substituted, even by legislative aid, without impairing the obligation of the contract between the company and the bondholders of 1858. One variance relied upon in this way was, that the substituted bonds were made to run for a longer time,—for fifteen years, instead of ten years. But the court did not regard this as of the essence of the contract. There was no specific mention of the time of credit in the reservation made in the mortgage, though the statutes providing for the issue of such bonds directed the officers of the state to allow them to run for ten years. The substantial circumstance as between the company and the bondholders under the mortgage of 1858 was, that the company had the right to impose upon the road a loan of 6,000 per mile and make it a lien prior to the mortgage which secured their bonds.

Another variance relied upon was, that the substituted mortgage did not require a sinking fund to be reserved for the payment of the bonds, as was the case with the bonds which were to be given to the state. This, again, was not regarded as affecting the substance of the rights as between the parties. It was rather a mode of providing for payment, and the company was neither richer nor poorer by reason of the sinking fund. This was a matter of detail for the officers of the state under the act authorizing the loan, but not a matter of essential concern to the bondholders.

But a variance in the rate of interest, the bonds to be given for the state loan bearing six per cent. interest, whereas the bonds authorized in their stead bore eight per cent. interest, imposed an additional burden upon the road beyond what was stipulated for. The rights of the bondholders under the first mortgage were therefore invaded to the extent of this increase in the rate of interest, and as against them the rate must be reduced to six per cent.

§ 61. **The mortgage usually provides in some form for the payment of taxes** by the mortgagor while in possession. A provision in the condition of a defeasance of a mortgage given by a railroad company to secure its bonds, that the mortgage shall be void if the mort-

gagor well and truly pays the debt and interest "without any deduction, defalcation, or abatement to be made of anything for or in respect of any taxes, charges, or assessments whatsoever," does not oblige the company to pay an income tax of five per cent. imposed by act of congress upon the interest payable upon the bonds, and which such companies "are authorized to deduct and withhold from the payments on account of any interest or coupons due and payable." On the contrary, the company complies with its contract when it pays the interest, less five per cent., and retains the tax for the government. The provision has reference only to ordinary taxes imposed upon the company and the property in its possession.[125]

§ 62. **A provision in the bonds of a corporation for their conversion into the capital stock of the company at the pleasure of the holder is inseparably connected with the bonds themselves,** and can be availed of only by a holder of such bonds, and only so long as he continues to hold them. He cannot assign this right of conversion, or his right of action for a breach of the stipulation for conversion, separate from the bonds. To recover in an action against the company for its refusal to convert the bonds, the plaintiff must aver and prove that he was at the commencement of his action the holder of the bonds for the conversion of which he brought suit.[126]

A privilege given in bonds issued by a company that the holders may convert them, at their option, within a specified time, into stock of the company, cannot be so exercised that a bondholder shall receive interest on his bonds and interest or dividends on the stock for the same period. Neither is he entitled to new stock issued to stockholders in place of dividends before he exercises his option to convert his bonds.[127] He is entitled merely to stock, and not to stock with dividends or interest thereon. If that were his right, the longer he delayed his election the more he would receive.

The right to convert bonds into stock is simply an option to take stock as the stock may turn out to be when the time for choice arrives. By such contract the bondholder does not become a stockholder in equity any more than at law. "So," says Justice Holmes for the

[125] Haight v. Railroad Co. 6 Wall. (U. S.) 15; 1 Abb. (U. S.) 81. See 1 Jones Mortgages, § 358.

[126] Denny v. Cleveland &c. R. Co. 28 Ohio St. 108.

[127] Sutliff v. Cleveland &c. R. Co. 24 Ohio St. 147.

Massachusetts court, "if the corporation which made the bond finds it to its interest to go out of existence at or before the maturity of the obligation, the option given to the bondholder will not stand in the way. The option gives him merely a *spes,* not an undertaking that the corporation will continue for the purpose of making it good. This being so, we are not prepared to admit that, if the corporation should be dissolved, at the time fixed for the bondholder's choice, he would be entitled to claim a proportionate share of the assets of the company. We do not decide the question, but we do not think it clear that the contract operates except in the event of the corporation happening to remain a going concern, so that the promise can be fulfilled in a literal sense by the delivery of a certificate of stock."[128]

But when the right to convert bonds into stock is given by a contract in the bond itself and the evident intent of a statute regarding a consolidation is to continue such a right, the right of a bondholder survives a consolidation and he can recover damages for the failure of the new company to issue stock in exchange for his bonds.[129]

It is no answer to a demand to convert bonds into stock that the company has no stock and could acquire none except by bidding it up in the open market to a ruinous rate. The company must comply with the demand or answer in damages to the extent of the market value of the stock at the date of the demand. It is also no answer that no other bondholders have made such demand.[130]

§ 62a. **Where the right to convert bonds into stock is conferred by an act of legislature,** it is a pure gratuity as between the company and the obligee. The bondholder's right, in such case, is subject to the condition that to enforce the option would not run counter to the legislative plan. A consolidation which makes no arrangement for furnishing stock in the new company, and which ends the existence of the old ones, may be presumed to put an end to the right of bondholders to call for stock, not because the law has not machinery for keeping such a right alive, but because, not being bound to do so, it has made dispositions which manifestly take no account of the right.[131]

[128] Parkinson v. West End St. R. Co. 173 Mass. 446, 53 N. E. 891.

[129] John Hancock Mut. L. Ins. Co. v. Worcester &c. R. Co. 149 Mass. 214, 21 N. E. 364.

[130] Batlen v. Catawissa R. Co. 211 Pa. St. 21, 60 Atl. 319.

[131] Parkinson v. West End St. R. Co. 173 Mass. 446, 53 N. E. 891, in the words of Justice Holmes.

§ 62b. **Under a statute authorizing railroad corporations to borrow money for certain purposes and to issue bonds** secured by mortgages of the corporate franchises and property, and providing that the "directors may confer on any holder of such bonds the right to convert the principal due or owing thereon into stock, under such regulations as the directors may see fit to adopt," it was held in *Belmont* v. *Erie Railway Company* that the directors of this corporation had the power to issue such convertible bonds, although the limit of the amount of capital stock fixed by its charter had already been reached, there being no condition imposed upon the right of the directors to authorize the conversion of such bonds into stock, except that the bonds be issued for the purposes specifically authorized; and this being so, it was further held that the directors had power to issue stock in conversion of such bonds.[132] It was declared, however, that if the court were satisfied that bonds were about to be issued by the directors, not for the payment of money actually borrowed for the purposes authorized by the statute, but as a part of a fraudulent device to increase the stock, the issuing of them might be restrained by injunction; and moreover, that while the bonds remained in the hands of any persons affected with notice that they did not represent a *bona fide* indebtedness, but were issued with such fraudulent design, the issuing of stock in conversion of the bonds might also be enjoined.[133]

This decision, that a corporation may, through the instrumentality of convertible bonds, issue stock after it has already reached the limit of its powers of issuing it, is of doubtful authority; but it illustrates one phase of the management of a great corporation, so much of whose history has been one of fraud and disaster from the beginning, reflecting no honor upon the great state whose courts have had so much to do in making up the humiliating record.[134]

§ 62c. **A bonus of stock given to the purchaser of bonds** does not make the bondholder liable as a purchaser of stock. Thus where bonds were to be paid for on installments and the stock bonus was deposited with the mortgage trustee to be delivered when the bonds

[132] Belmont v. Erie R. Co. 52 Barb. (N. Y.) 637; and see Ramsey v. Erie R, Co. 38 How. Pr. (N. Y.) 193, 217.

[133] Belmont v. Erie R. Co. 52 Barb. (N. Y.) 637, per Cardozo, J.

[134] See "Chapters of Erie," by Charles F. Adams, Jr.

were paid for, a failure to pay for the bonds did not make the subscriber liable as for an unpaid subscription for stock.[135]

§ 63. A mortgage deed may be reformed. Thus a mortgage to trustees for bondholders, from which words of inheritance have been inadvertently omitted, will be reformed as against subsequent incumbrancers and purchasers, when it appears from the deed itself, as recorded, that the nature of the trust required that an estate in fee should pass by the deed.[136] The New Jersey West Line Railroad Company made such a mortgage, and constructive notice of the entire instrument was afforded by the record of it.[137] "It was a conveyance, by way of mortgage, in trust, and the estate intended to be conveyed to the trustees may be ascertained from the provisions of the trust itself. If they require for their execution that the trustees shall have an estate in fee, then an estate in fee will be held to have passed to them. The mortgage provides that, in case of default for the period of six months after presentation of coupons for interest and demand of payment, or default for six months in payment of principal, the trustees, or the survivors of them, or their successors, may sell and dispose of the mortgaged premises, and make and deliver to the purchaser or purchasers thereof good and sufficient deed and deeds in the law, in fee simple, therefor; and that the sale and conveyance so made shall be a perpetual bar, both in law and in equity, against the company, and all claiming or to claim the property under it, or its successors or assigns; and that the sale shall vest the right title, estate, interest, property, and possession of, in, and to the premises, wholly and absolutely in the purchaser or purchasers. To execute this provision of the mortgage a fee in the trustees is necessary, for they could not convey a fee if they themselves had only a less estate. This provision is of itself evidence and notice of the estate intended to be

[135] Davis Bros. v. Montgomery &c. Co. 101 Ala. 127, 8 So. 496.

[136] Coe v. New Jersey &c. R. Co. 31 N. J. Eq. 105.

[137] Randolph v. New Jersey &c. R. Co. 28 N. J. Eq. 49.

The habendum of the mortgage was to the trustees, as joint tenants, and not as tenants in common, and to the survivors of them, and their successors and assigns, as joint tenants, and not as tenants in common as aforesaid, to the only proper use, benefit, and behoof of the trustees, and the survivor of them, and their successors and assigns, as joint tenants, and not as tenants in common as aforesaid, forever, in trust, nevertheless, etc. See 1 Jones Mortgages, §§ 97–99.

conveyed by the mortgage, that it was an estate in fee. The mortgage, therefore, may be reformed, as prayed in the bill, in the words of conveyance and in the habendum clause, as against all the defendants."

In seeking a reformation of a corporate mortgage to have it conform with a resolution of directors authorizing it, it is necessary to allege and show that consent of two-thirds of the stockholders, necessary to the execution of the mortgage, was given to the mortgage in the form which the petitioner desires and corresponds with the vote of the directors.[138]

§ 63a. Construing contemporaneous lease and mortgages together. —Where one railroad company leases to another its unfinished road and also mortgages it to secure bonds which are delivered to the lessee, and the lessee executes a mortgage on earnings to the trustee for bondholders, these three writings, being executed simultaneously, are to be read together as one contract. The undertaking to restore the leased premises in good repair being for the benefit of bondholders, the trustee may sue the lessee for breach of that covenant and a debt from the lessor to the lessee does not exclude the liability of the lessee to the bondholders. As security for the bonds it is important that the *corpus* of the property which is leased shall be kept in repair and restored in good repair at the termination of the lease. The lease is not susceptible of the construction that the lessee is not to turn over the property in good repair in case the lease is terminated by foreclosure.[139]

§ 63b. A provision in a second mortgage securing an issue of bonds that holders of first-mortgage bonds may exchange them for the later issue does not confer an absolute right to such an exchange. At the time the second-mortgage bonds were issued it was to the advantage of the railway to retire the first-mortgage bonds and make the second mortgage a prior lien, but as the first-mortgage bonds drew near maturity, holders of them, after a long delay, could not insist upon an exchange, the other bonds being worth more in the market because they had a longer time to run. The holders of the outstanding bonds

[138] Trust Co. of N. Y. v. Universal T. M. Co. 90 App. Div. (N. Y.) 207, 86 N. Y. S. 60.

[139] Louisville & N. R. Co. v. Schmidt, 112 Ky. 717, 66 S. W. 629; Louisville & N. R. Co. v. Schmidt, 95 Ky. 290, 25 S. W. 494; Louisville & N. R. Co. v. Schmidt, 101 Ky. 441, 41 S. W. 1015, 38 L. R. A. 809.

were not parties to the agreement for an exchange. No trust was created for their benefit and it is time enough to consider their rights when default is made in the payment of their bonds.[140]

§ 64. **Recording.**—A mortgage by a railroad company or other corporation, so far as concerns its real property, is ordinarily subject to the same laws and rules of law in regard to recording that a mortgage of real property by an individual is.[141]

In several states, however, it is provided that railroad mortgages shall be recorded in the office of the secretary of state.

In case, however, of a mortgage made by a corporation to a state in pursuance of a public statute granting aid to the corporation, the state will not be prejudiced by the neglect of her agents to have the mortgage recorded; for all persons are required, at their peril, to take notice of a public statute.[142]

If a mortgagee takes possession of personal property before adverse liens attach, his possession has been held to validate an unrecorded chattel mortgage on railway property.[143]

[140] Morse v. Chicago &c. R. Co. 84 App. Div. (N. Y.) 406, 82 N. Y. S. 698.

[141] Hebberd v. Southwestern Land &c. Co. 55 N. J. Eq. 18, 36 Atl. 122. In Knickerbocker Trust Co. v. Penn Cordage Co. 66 N. J. Eq. 304, 58 Atl. 408, it was held that a mortgage by a corporation covering both real and personal property must be recorded as a chattel mortgage in order to include the personalty.

[142] Memphis &c. R. Co. v. State, 37 Ark. 632. The recording of railroad mortgages, so far as they cover rolling stock and other personal property, is considered in Chapter v.

[143] State Trust Co. v. Kansas City P. & G. R. Co., 120 Fed. 398.

CHAPTER III.

PROPERTY COVERED BY RAILROAD MORTGAGES.

I. What is embraced in a mortgage of the undertaking, §§ 65–69.
II. What property passes as appurtenant to the franchise, §§ 70–74.
III. What personal property passes as fixtures, or parts of the realty, §§ 75–79.
IV. What is covered by a mortgage of the tolls and income of a railroad, §§ 80–90.

I. What is Embraced in a Mortgage of the Undertaking.

§ 65. **In England a railway mortgage usually embraces only the "undertaking" of the company, and the tolls and moneys** arising out of the "undertaking." This is different from a mortgage of the property of the company.[1] By the term "undertaking" is meant the railway as a completed whole by which tolls and profits are earned. Various ingredients go to make up the undertaking, but these ingredients, strictly speaking, are not the subjects of the mortgage, but only the completed work from which the earnings come. The term "undertaking" is the proper style, not for the ingredients, but for the completed work.[2]

[1] Perkins v. Pritchard, 3 R. & Can. Cas. 95; Hart v. Eastern Union R. Co. 6 R. & Can. Cas. 818; 7 Exch. 246, 265.

[2] "It is in this sense, in my opinion," said Lord Cairns, "that the 'untertaking' is made the subject of a mortgage. Whatever may be the liability to which any of the property or effects connected with it may be subjected through the legal operation and consequences of a judgment recovered against it, the undertaking, so far as these contracts of mortgage are concerned, is, in my opinion, made over as a thing complete, or to be completed, as a going concern, with internal and parliamentary powers of management not to be interfered with—as a fruit-bearing tree, the produce of which is the fund dedicated by the contract to secure and to pay the debt. The living and going concern thus created by the legislature must not, under a contract pledging it as security, be destroyed, broken up, or annihilated. The tolls and sums

The London, Chatham, and Dover Railway Company, having made a mortgage of its undertaking and the tolls and profits arising from that, a question arose upon default in the payment of the money received, whether a receiver should be appointed of the rents, and of the sale proceeds of certain surplus lands. Such lands in England may be acquired in one of two ways: they may be lands taken by the railway company in the belief that they would be required for its line, or for the stations and works connected with it; or they may be lands which the owner has forced the company to buy, in order that he may not have a severed part of a tenement or field left on his hands. In either case the company is obliged to resell the land within a limited time, applying the proceeds to the purposes of the company.[3]

of money *ejusdem generis*—that is to say, the earnings of the undertaking—must be made available to satisfy the mortgage; but, in my opinion, the mortgagees cannot, under their mortgages, or as mortgagees, by seizing, or calling on this court to seize, the capital or the lands, or the proceeds of sales of land, or the stock of the undertaking, either prevent its completion or reduce it into its original elements when it has been completed." Gardner v. London &c. R. Co. L. R. 2 Ch. App. 201, 217, 36 L. J. Ch. 323.

[3] Gardner v. London &c. R. Co. L. R. 2 Ch. App. 201, 217, 36 L. J. Ch. 323. "It is obvious from this," said Lord Justice Cairns, delivering the decision of the court, "that the surplus land is in truth the representative and equivalent of a certain portion of the capital provided by the company for the execution of their works, which has—not for the purposes of profit, but for the protection of landowners—been temporarily diverted and invested in land to be again resold, and which is to return to the capital of the company when the object for which it was diverted has been accomplished. And as regards the *interim* rents, if any, of surplus lands, they would appear to be in the same position as the income arising from capital provided by the company, and temporarily invested in any other manner until needed. The argument by which the debenture holders maintained their right to a receiver of the proceeds of the surplus lands is in substance this: They say they are mortgagees of the undertaking, and of the tolls and sums of money arising out of it, or by virtue of the act authorizing it; that all the land taken by the company under its parliamentary powers goes, in the first instance, to form a part of the undertaking; that as soon as any land becomes surplus land, it becomes subject at the same time to the parliamentary provision for its resale, but the sale moneys are in return subjected to this trust; that they are to be applied for the purposes of the special act, that is, for the purposes of the undertaking; that these moneys, therefore, become and form a part of the undertaking, and therefore of the secur-

In conclusion, it was held that the debentures did not constitute a mortgage of the whole of the property and effects of the company, as parts of the undertaking; and therefore that the sale moneys of the surplus lands were not embraced in the mortgage. The company having given a charge upon these lands to contractors to the railway, a receiver was appointed of the proceeds of the sale of them in favor of the assignees of the contractors.

§ 66. **The word "undertaking," having no settled meaning, must be construed with reference to the obvious intention** of those who employ it. While the word does not, *prima facie,* include the lands of the company, it does not necessarily exclude them. As declared by Mr. Justice Coleridge,[4] "That word is ambiguous, and may be construed as meaning the speculation generally, or possibly it may be taken to include the land itself." This point is further illustrated by the case of the New Brunswick and Canada Railway Company. By various

ity, and ought to be preserved and applied for them by this court. It is necessary to observe carefully to what length this argument must go. A railway is made and maintained by means of its capital, by means of its borrowed money, of its land, of its proceeds of sale of surplus land, of its permanent way, of its rollstock. All these may be said, in a sense, to be connected with, to be parts of, to make up, the undertaking. If a mortgage of the undertaking carries *in specie* the sale moneys of surplus lands, it must equally, and on the same principle, carry *in specie* the ordinary land of the company, the capital, the permanent way, the rolling stock, nay, even the very money itself lent on the mortgage. The assignment made by the mortgage debenture is immediate, and is to continue for three years at the least. If the debenture holders are right in their argument, they become immediate assignees *in specie* of all the ingredients which I have enumerated as going to make up the undertaking, and they might from the first have asserted their rights as mortgagees by taking and impounding, not merely the proceeds of surplus lands, but the capital, the cash balances, the rolling stock, and even their own money advanced. Now, it is beyond question that the great object which parliament has in view, when it grants to a railway company its compulsory and extraordinary powers over private property, is to secure in return to the public the making and maintaining of a great and complete means of public communication; and yet, according to the necessary consequence of the plaintiffs' argument, the moment the company borrowed money on debentures it would depend on the will or caprice of the debenture holder whether the railway was made at all."

[4] Myatt v. St. Helen's &c. R. Co. 2 Q. B. 364.

acts of the imperial and colonial legislatures, this company was entitled to grants of a large amount of land not connected with or necessary for the completion of the railway. This land the company had taken as a land company, with the object of making it a source of profit by sale and otherwise. It issued debentures, mortgaging to each holder the undertaking, and all moneys to arise from the sale of lands, and all future calls, and all tolls, engines, rolling stock, and all the estate, right, title, and interest of the company in the same, provided that nothing therein contained should be held to limit the power of sale or appropriation by the company of any of its lands, nor constitute a charge upon them. Certain judgment creditors of the company issued execution against the land of the company, whereupon the debenture holders, in order to protect the lands of the company, and restrain a sale of the lands by the judgment creditors, instituted a suit in the supreme court of New Brunswick, and obtained an order appointing a receiver. A motion for an injunction having been refused by one of the judges, and, upon appeal, again refused by the supreme court of judicature of the province, an appeal was taken to the privy counsel, which affirmed the decree of the provincial court.[5]

§ 67. **The word "undertaking" is frequently used in connection with other general words,** and the effect of that word, and of the

[5] Wickham v. New Brunswick &c. R. Co. L. R. 1 P. C. 64; 1 Cox's Joint Stock Cas. 519. Lord Chelmsford, delivering the opinion, said that the proviso was not inconsistent with the sweeping and general terms of the debenture, but merely explanatory of them. "It seems clear to their lordships that, the lands not being in terms granted by the mortgage debentures, the proviso makes the intention of the parties perfectly clear, that no general expression used in the grant was intended to comprehend them, and therefore that the debenture holders are not entitled to interfere with the sale of the lands under the execution issued by the judgment creditors. But the debenture holders insist that, if they cannot stop the sale of the lands, they are entitled, under the terms of the debentures, to all the moneys arising from such sale. It is quite clear, however, that the sales contemplated by the grant are those which are to be made by the company in the course of their regular operations. The judgment creditors take what belonged to the company, but do not take under them; and a sale by the sheriff under an execution is a sale by law, and not by the company. It is clear, upon the whole case, that the lands of the company did not pass to the mortgagees under the debentures, nor are they entitled to the proceeds of the forced sales."

others as well, is to be determined in some measure by the connection; and especially is this the case in reference to the question whether the charge is upon the income merely, or as well upon the property. A mortgage of "the undertaking and all the real and personal estate" was held to include all the personal estate then existing, but not personalty subsequently acquired.[6] A company whose business was to buy and sell land, to build, buy, and sell houses, to furnish houses for hotels, and to carry on the business of hotel-keepers, pledged "the property belonging to us for the time being, during the subsistence of the debenture, with all the buildings and stock on, and connected with, our said property, and all the receipts and revenues to arise therefrom," and declared that the entire debenture loan and interest should be a first charge on "our undertaking, and property, and receipts, and revenues aforesaid." Upon the winding up of the company it was held that the effect of the debentures was to give the holders a charge, in priority to other creditors, upon the land and other property of the company.[7]

Whether the term "undertaking" constitutes a charge upon the income merely, or as well upon the property itself, depends very much upon the purpose of the corporation and the nature of the property involved. When the property consists of a permanent railway, all parts of which are essential to the continued existence and operation of the company, whose charter was granted for the purpose of securing the public convenience, it is not consistent with the policy of the English law to allow the property itself to be mortgaged, sold, or dealt with in any way so as to endanger the permanent maintenance of the railway; and therefore a mortgage of the undertaking is construed, with reference to the peculiar subject-matter to be affected, to mean the income of the property and not the *corpus* of it.[8]

§ 68. **The mortgage debenture in common use in England is not accompanied by any separate instrument,** such as a bond or note, affording a personal remedy against the corporation; but the mortgage itself usually contains a covenant for the payment of the principal of the loan.[9] Such a debenture in the usual form was made by the

[6] New Clydach &c. Iron Co., In re, L. R. 6 Eq. 514.

[7] Marine Mansions Co., In re, L. R. 4 Eq. 601. See also General South American Co., In re, L. R. 2 Ch. D. 337.

[8] Panama Mail Co., In re, L. R. 5 Ch. 318, 321, per Giffard, L. J.

[9] Hart v. Eastern Union R. Co. 6 R. & Can. Cas. 818, 7 Exch. 246, 265.

Eastern Union Railway Company, by which it assigned "the said undertaking, and all the estate, right, title, and interest of the company in the same, to hold until the sum of £1,000, together with interest for the same at the rate of £5 for every £100 by the year, be satisfied; the principal sum to be paid on the first day of January, 1851." The question arose whether this instrument afforded a personal remedy against the company. Baron Parke, delivering the opinion of the court of exchequer, holding that an action was maintainable upon it, said of this instrument: "The first part merely assigns, in consideration of £1,000, the undertaking, and all the tolls and sums of money arising by virtue of the act, to hold until the sum of £1,000, with £5 per cent. interest per annum, should be satisfied. If the instrument had stopped there, it would have operated simply as a transfer (commonly, but improperly, called a mortgage) of the subject-matter till the sum was satisfied thereout. The subject conveyed would be the tolls, certainly the unpaid calls, and probably all that belonged to the company as the proprietors of the railway, which any one is at liberty to use on paying tolls, but not the stock or property belonging to the company as common carriers of passengers or good for hire, nor, according to the case of *Myatt* v. *St. Helen's Ry. Co.*,[10] the soil of the railway itself. The railway acts have been prepared on the model of the canal acts, in which the principal object of the company is the proprietorship of the canal, and the profits derived from the use of it by the public in general; but soon after the establishment of railways it was found that the companies alone could use them beneficially by themselves monopolizing the conveyance upon them; so that the theory of these acts and the practice under them are entirely at variance. So far, the instrument we are considering would give no right of action to the plaintiffs, and would resemble that in *Pontet* v. *Basingstoke Canal Co.*;[11] but in the conclusion there is a stipulation that the principal is to be paid on the first of January, 1851; and this certainly imports a covenant by the company that the sum shall be repaid on that day, unless there be something in the acts to qualify or alter the meaning of that expression. The effect, then, of the instrument would be to pledge the tolls and property of the company as proprietors, but not their stock or property as carriers; and to impose an obligation on them to repay the principal on a certain day; for the breach of

[10] 2 Q. B. 364.

[11] 3 Bing. N. C. 433.

which an action would lie against the company, the judgment in which action would be satisfied out of their general property belonging to them as carriers or otherwise." A writ of error having been brought on this judgment, it was affirmed.[12]

§ 69. **In England future calls on the shareholders cannot be mortgaged without express legislative authority,** so as to preclude the company from receiving and applying them to the purposes of the company.[13] Existing unpaid calls, even, will not be included in a mortgage, unless there are clear words showing an intention to include them; thus, where the terms employed were, "all the lands, tenements, and estates of the company, and all their undertaking," it was held that calls, whether to be made or whether made and remaining unpaid, were not included.[14]

II. What Property Passes as Appurtenant to the Franchise.

§ 70. **Under a mortgage of a road, "with its corporate privileges and appurtenances," only such property passes as is directly appurtenant to the road,** and is indispensably necessary to the enjoyment of its franchises.[15] Therefore such a mortgage does not cover town lots adjoining the roadbed, without specific mention of the lots, although purchased by the company ostensibly for a basin to connect the road with river navigation, unless as a matter of fact such lots are essential to the enjoyment of the corporate franchises.[16] It does

[12] Eastern Union R. Co. v. Hart, 8 Exch. 116.

[13] British Provident &c. Ass. Co., Matter of, 4 De G., J. & S. 407; Sankey Brook Coal Co., In re, L. R. 10 Eq. 381; Companies Clauses Consolidation Act, 1845, 8 & 9 Vict. ch. 16, § 43; Gardner v. London &c. R. Co. L. R. 2 Ch. 201, 212, per Cairns, L. J.; Lewis v. Glenn, 84 Va. 947, 6 S. E. 866.

[14] King v. Marshall, 33 Beav. 565.

[15] State v. Glenn, 18 Nev. 34, 1 Pac. 186; Morgan v. Donovan, 58 Ala. 241.

[16] Shamokin Valley R. Co. v. Livermore, 47 Pa. St. 465, 471, 86 Am. Dec. 552. Upon the relation of such property to the road, Mr. Justice Agnew said: "So far as the railroad was involved, its purposes were of a public nature—the transportation of freight and passengers; but so far as the company prosecuted the coal trade, it was an object of private gain, not essential to the railroad franchise, and which they might or might not prosecute at pleasure. Now, admitting that the company might, by implication from

not cover a hotel not used in connection with the road and for its convenience, but as an ordinary hotel.[17] But it covers a hotel used for the accommodation of the patrons and employes of the road.[18]

A mortgage of all the franchises, lands, and appointments of the main line of a railroad, then owned by the company or thereafter to be acquired, does not include a lateral branch, or extension subsequently made.[19]

A mortgage of the main line of a railroad and its appurtenances, located in the state of Arkansas, does not cover real estate, depot buildings, and trackways, situated in Tennessee, across the state line from the terminal point of the main railroad line; but such property is subject to attachment in the courts of the latter state.[20]

A mortgage by a railroad company of property which it was not authorized to acquire or hold, is not effectual to pass such property if the words of conveyance describe the property mortgaged as property used or to be used in the construction and management of the company's road. Thus, where a charter of a railroad company authorized it to acquire and hold property to be used in the construction and operation of the road, or in connection therewith, and a mortgage used like terms in describing the property conveyed by the mortgage, the mortgagé was held not to include property acquired by the company

the language of the charter, establish a basin, as a device for the more convenient carrying on of the coal trade, yet it was a work not essential to the railroad franchise involving the public interests, and therefore one the company might establish or withdraw at their pleasure. A basin may be very convenient to enable boats to approach a railroad and take freight from its cars, but clearly it does not belong to it, constitutes no essential incident, and, therefore, like warehouses, coal yards, machine shops, etc., is an independent structure." See also Boston &c. R. Co. v. Coffin, 50 Conn. 150; Mississippi &c. Co. v. Chicago &c. R. Co. 58 Miss. 896, 38 Am. R. 348n; Alabama v. Montague, 117 U. S. 602, 6 S. Ct. 914; Millard v. Burley, 13 Neb. 261, 13 N. W. 278. When lots used in part for depot grounds are included in a general decree of sale, the burden is on defendant to show that they were not included in the mortgage. Knevals v. Florida Cent. R. Co. 66 Fed. 224.

[17] Mississippi Val. Co. v. Chicago, St. L. &c. R. Co. 58 Miss. 896, 38 Am. R. 348n.

[18] United States Trust Co. v. Wabash &c. R. Co. 32 Fed. 480.

[19] Randolph v. New Jersey &c. R. Co. 28 N. J. Eq. 49; Alexandria & F. R. Co. v. Graham, 31 Gratt. (Va.) 769; Hodder v. Kentucky &c. R. Co. 7 Fed. 793.

[20] Buck v. Memphis &c. R. Co. 4 Cent. L. J. 430. See § 143.

from an opposition steamship line, for the purpose of withdrawing it from business and preventing competition, which property was never used, nor intended to be used, by the company in connection with its railroad, or as appurtenant to it.[21]

§ 71. **Change of route.**—A mortgage conveying the franchise of a railroad company and all property to be acquired, covers the road as built, although a change be made in the route from that originally contemplated and described in the mortgage. The purchasers at a foreclosure sale under such mortgage acquire all the title to the road that the bondholders had a right to have sold; or, in other words, title to the road as constructed.[22]

In Iowa it is provided that, upon a change of location or removal of the line of road, all mortgage liens and other incumbrances on the line of road which the company is authorized by the court to change shall remain valid liens and incumbrances on the line of road to which the change is made, and shall take priority of all other liens and incumbrances upon such new line of road.[23]

It is also provided in Ohio that when any railroad company shall, with the written consent of three-fourths in interest of the stockholders, change its line or any part of it, either partly or wholly constructed, or the proposed termini, and shall file a copy of the resolution with the secretary of state, the record of any mortgage the company may have executed to secure bonds for the construction of such a road, in each county through which the changed line of such railroad shall pass, is as effectual to create a lien upon the changed line of such railroad and upon all the property of such company as if such mortgage contained a complete description of such changed line and of such property.[24]

A mortgage of a water ditch for mining purposes does not cover a new independent ditch subsequently constructed by a purchaser from the mortgagor along a different course and between different termini, for the purpose of being used in place of the mortgaged ditch, in case the new ditch is not an appurtenance of nor an improvement on the original ditch.[25]

[21] Morgan v. Donovan, 58 Ala. 241.

[22] Elwell v. Grand St. &c. R. Co. 67 Barb. 83.

[23] Laws 1876, ch. 118, § 5.

[24] Laws 1876, ch. 115.

[25] Mitchell v. Canal Co. 75 Cal. 464, 17 Pac. 246.

§ 72. **Woodland not connected with the road.**—The Racine and Mississippi Railroad Company made a mortgage of its road and superstructure, track, and all appurtenances, made or to be made, the land upon which the road had been or should be constructed, including the depots, shops, engine-houses, and other constructions at the termini and along the line of the road and the land upon which the same were erected, and that which should be used for depot and station purposes. The company afterward purchased a large tract of woodland, situated seven miles from the road, for the purpose of supplying it with timber and fuel. Upon a foreclosure of the mortgage it was insisted that this tract of land was embraced in the mortgage; but the supreme court of Wisconsin held otherwise, upon the ground that this land was not included within the express terms of the mortgage.[26]

A mortgage of a railroad, its property and franchises, does not, without special mention, include land purchased under the authority of a provision in its charter which authorized the company to hold such an amount of land, not exceeding five acres in any one place, and improvements, at the termination and along the line of the road, necessary for water stations, the accommodation of passengers, and the shipping of goods, and for shops and like purposes, if the land so purchased be not appropriated or used for these purposes.[27]

§ 73. **Canal boats** owned by a railroad company and used by it in connection with its road, but beyond the terminus of it, are not included in a mortgage of the road which does not specify them, except under the general description of "all other personal property whatsoever in any way belonging or appertaining to the said railroad." The boats might be said to be in a general way accessory to the business of the road, but they cannot be said to belong or appertain to the road.[28]

Although a corporation, in excess of the powers conferred upon it by its charter, purchases and pays for steamboats and canal boats, it may, when once in possession of such property, make a valid mortgage of them. Neither the corporation nor any one claiming under it can set up a violation of its chartered powers to defeat the title of a

[26] Dinsmore v. Racine &c. R. Co. 12 Wis. 649; Alabama v. Montague, 117 U. S. 602, 6 S. Ct. 911.

[27] Youngman v. Elmira &c. R. Co. 65 Pa. St. 278; Chapman v. Railroad Co. 26 W. Va. 299.

[28] Parish v. Wheeler, 22 N. Y. 494.

mortgage. On the other hand, the mortgagee having sold the property under his mortgage cannot, on this ground, excuse himself from accounting for the proceeds of the sale upon the mortgage debt.[29]

§ 74. An equitable right of action may be the subject of a mortgage, yet it is important that such right should be described, both in the mortgage and in the advertisement of the sale under it, so that it shall be apparent that the intenion was to include the right in the mortgage and the sale. The La Crosse and Milwaukee Railroad Company having mortgaged its road, afterward sold and conveyed one branch or division of it to the Milwaukee and Western Railroad Company, which assumed the payment of a portion of the mortgage debt, and covenanted that upon default in the payment of the principal or interest of such portion the former company might re-enter upon the premises and foreclose and sell the same. Subsequently the La Crosse and Milwaukee Company executed another mortgage of its line of road from Milwaukee to La Crosse, with all the real property, rolling stock, and franchises connected with the road, together with all the bonds, negotiable paper, accounts, "causes of action," demands and choses in action, of whatever nature," which the company might own or have any interest in on the day of its first making default on the bonds secured by the mortgage. Default was made under this mortgage and the property as described in the mortgage was sold under a power of sale, and was bought by a trustee in behalf of the bondholders. The purchaser claimed the benefit of the covenant made by the Milwaukee and Western Company in favor of the La Crosse and Milwaukee Company, and sought to enforce it by suit. It was held, however, that, whether a right to enforce the covenant could be mortgaged by general language like that contained in this mortgage or not, still such a right would not pass by a sale under the power without a more definite description in the notice of sale, so that purchasers might know what they were purchasing.[30]

[29] Parish v. Wheeler, 22 N. Y. 494; Bissell v. Michigan &c. R. Cos. 22 N. Y. 258.

[30] Milwaukee &c. R. Co. v. Milwaukee &c. R. Co. 20 Wis. 174, 88 Am. Dec. 740, 188.

Mr. Justice Cole, delivering the opinion of the court, said: "A sale at auction and upon notice implies that there is some designation of the thing offered to be sold, so that persons whom the law invites to such auction may be able to know where and what is the property they

Book debts of a company may be mortgaged under a power to raise money by mortgage, with or without power of sale, of any of the property of the company. Such debts, whether accrued or not, are property.[31]

A claim for unpaid subscriptions to corporate stock is not covered by a general mortgage of the railroad and its appurtenances.[32]

III. What Personal Property Passes as Fixtures or Part of the Realty.

§ 75. **A railroad track laid down for the permanent use of the road is a fixture** and a part of the realty. But a track may be personal property and no part of the real estate. Whether in any case it be realty or personalty is perhaps a mixed question of law and of fact, like most questions as to fixtures. A track laid, for instance, for the purpose of taking gravel from gravel pits, may be realty or personalty; and in determining which it is, the purpose with which it was put down is of more importance than the manner in which it is annexed to the land. If permanent in its character and use, or intended to be appropriated to the land for its use and benefit, and adapted to any use or purpose to which the land could be put, and if at the same time it is so laid that it cannot be easily moved, it is a part of the realty and passes by a conveyance. But if the track was neither originally built upon the land for the use and benefit of the land, nor in anywise adapted to the uses to which the land could be put; and if the structure be not of a permanent character, but temporary, so that it could be easily moved on the ground and taken therefrom without any injury to the land, and it was not intended by the parties who built it and owned the land at the time it was built that it should be appropriated to the use of the land, but simply to enable the railroad com-

are about to purchase. In case of selling a railroad it might be sufficient to designate the property sold as a railroad between given points, with its rights, privileges and franchises. But it seems to me, if choses in action and legal instruments are to be sold, there ought to be some description or designation of them. Otherwise such sales will be a mere idle ceremony, resulting frequently in great injury to the debtor company, and leading to the most fraudulent speculations. If the covenants in this indenture were actually sold by the trustee, and he bid in reference to them, it should be so averred."

[31] Bloomer v. Union Coal &c. Co. L. R. 16 Eq. 383.

[32] Dean v. Biggs, 25 Hun (N. Y.) 122.

pany to take the gravel from the land, the track would not be a fixture or appurtenance belonging to the land, but personal property, which might be removed by the owner of the track without incurring any liability to the owner of the land.[33]

§ 76. **Materials placed upon the land of a railway for use in repairing the road,** such as iron rails, chairs, spikes and ties, constitute a part of the realty and pass by a mortgage of the road.[34]

§ 77. **An iron safe not attached to the freehold is personal property,** and liable to be taken on execution against the company; and an iron planing-machine is also personal property, unless it is so connected with and attached to the realty as to indicate that it is designed to be permanent, or its removal would be injurious to the freehold.[35]

Office furniture used in one of the offices of a railroad company passes by a mortgage of all its property real or personal belonging to it, and used as a part of it or appurtenant thereto. If such property is attached or levied upon by an unsecured creditor of the company with knowledge of the mortgage, the mortgage trustee may recover the property, unless such creditor shows that the property is not necessary to the security of the mortgage bondholders.[36]

That such property as station-houses, engine-houses, freight-houses, and the workshops of a railroad company, with their appurtenances, and also piers and wharves and their appendages, when annexed to land of the company covered by a mortgage, become part

[33] Van Keuren v. Central R. Co. 38 N. J. L. 165, 13 Am. Rep. 43.

[34] Palmer v. Forbes, 23 Ill. 301, 314. "Nor do we want analogies in the well-settled principles of the common law to hold that materials provided and designed to be attached to the road are, for the purposes of a mortgage or a conveyance, a part of the real estate itself. It is a familiar principle to all that rails hauled on to the land, designed to be laid into a fence, or timber for a building, although not yet raised, but lying around loose, and in no way attached to the soil, are treated as a part of the realty, and pass with the land as appurtenances. By applying these familiar principles of the common law, we may be enabled to determine what we should consider as appurtenant to the freehold, and what should pass by a conveyance of the road, and consequently what is covered by and embraced within a mortgage incumbering the road, acknowledged and recorded as a mortgage of real estate." Per Caton, C. J.

[35] Titus v. Mabee, 25 Ill. 257. See § 113.

[36] Raymond v. Clark, 46 Conn. 129.

of the realty embraced in the mortgage, would be questioned by no one. But tools and implements in the work-shops, and furniture in station-houses, and all other property of a personal nature, such as is commonly used for other than railway purposes, are not part of the realty subject to such mortgage.[37]

§ 78. **Cast-off articles, such as broken wheels, broken rails, broken ties,** and other scrap and refuse iron, once forming a part of the road, or used in its operation, and subject to a mortgage of it, but which have ceased to be of any value to the company, except for sale, or for recasting into new articles for the use of the road, still remain subject to the lien of the mortgage, if a proper management of the road required that they should be repaired, recast, or exchanged for new articles.[38]

§ 79. **Coal, wood, oil, and property of like description** intended for daily consumption, are personal property, and subject to the rules that govern the transfer of such property.[39]

In a case before the Supreme Court of Illinois, the question whether fuel, office furniture and other detached property of like nature of a railway company was embraced within a mortgage executed and

[37] Williamson v. N. J. Southern R. Co. 28 N. J. Eq. 277, 284, per Runyon, Chancellor.

[38] Coopers v. Wolf, 15 Ohio St. 523. "If such property is liable to execution," said Mr. Justice Welch, delivering the opinion of the court, "where shall we draw the line between the property of the mortgagees and that of the company? When a bridge breaks down, or a tunnel falls in, or when trains are thrown from the track and broken, shall executions be immediately levied upon the stone, the timbers, and the broken cars or engines? Shall creditors of an insolvent company line its track, and watch for and seize its wornout rails, broken wheels, fragments, and scraps, as fast as they come to hand; their priority over each other depending on their diligence in the business? If so, it is easy to see that the security of the mortgagees, which depends, ultimately and almost solely, upon the ability of the road to run and produce a revenue, would be seriously impaired. Besides, it would be almost impracticable to mark the boundary between the rights of the mortgagees and those of the judgment creditors, and the result would be a scramble between creditors, continual litigation, without any nearer approximation to justice and equity between the parties."

[39] Palmer v. Forbes, 23 Ill. 301, 312. See § **112.**

recorded as a mortgage of real estate, was considered in all its aspects. It was determined that such property could not be considered as attached to the realty, or as savoring of it so as to pass as fixtures, or incident to it.[40]

[40] Hunt v. Bullock, 23 Ill. 320, 322, 327.

"When it became apparent," said Mr. Justice Walker, delivering the opinion of the court, "that the exception was untenable, that it was real estate, then refuge was sought under the broad mantle—franchise; and wood, coal, writing desks, stationery, and all kinds of household furniture, which could not be called real estate, and must not be called chattels, and subject to the rules of law governing such property, were called franchise. What, then, is this franchise which it is claimed may transmute personal into real estate, and change the very nature and use of things in such a manner? It is only an immunity, privilege, or exemption from the ordinary burdens and restrictions to which the citizens of the state or government are generally subject, and is usually granted to bodies corporate or politic, for public convenience. This privilege, or the franchise, when granted to such bodies, is found alone in their charters, or the law which brings them into existence. In all other things, outside and independent of their charter privileges, they have always been held amenable to, and are governed by, the general laws of the state, to the same extent and in the same manner as individuals. The courts are powerless to extend their privileges beyond the grant contained in their charter, either in express terms, or from necessary implication, to effectuate the objects of their creation." It was likewise urged, that the railroad companies, in executing mortgages or deeds of trust, are not required to conform to the statute regulating chatel mortgages, in respect to property which is purely personal; that public policy requires that effect should be given these instruments in despite of the statute; but the court held the statute to be as obligatory upon railroad companies as upon other corporations or upon individuals. "That these corporations, when they mortgage their road, tracks and franchises, thereby mortgage all of the permanent fixtures, such as the road equipments for their continued use, and connected with them, we have no doubt. And by such a mortgage all future additions to it, of the same permanent nature, being an incident to the real estate, must become subject to the mortgage, as do improvements to other real estate mortgaged by individuals. So of repairs to personal property of the road legally mortgaged, and not designed for daily consumption. But that fuel, office furniture, stationery, materials for lights, and all other detached property of that character is personalty, we have no hesitation in determining. To hold otherwise would, it seems to us, involve us in an absurdity, if followed to its inevitable consequences, that we are not prepared to adopt, for the purpose of relieving against what might appear to be a hardship in a particular case."

In Indiana, however, it has been held that a mortgage of a railroad and its appurtenances, "with the superstructure, rails, *and other materials used thereon,*" embraces wood provided for the use of the road from time to time.[41] Although such property may be levied upon by a creditor of the railroad company, and the mortgagee is not entitled to an injunction against the proceeding, because the mortgagor's right of redemption is a leviable interest, yet the purchaser at the sheriff's sale is not entitled to possession of the property sold until he complies with the conditions of the mortgage.[42] Practically, therefore, under this rule, there can be no effectual levy upon the mortgaged property.

IV. What is covered by a Mortgage of the Tolls and Income of a Railroad.

§ 80. **The earnings of a railroad, while it is allowed to remain in the possession of the mortgagor,** are not subject to the lien of the mortgage, although in terms the mortgage covers the tolls of the road, if at the same time the mortgage implies that the mortgagor is to hold possession and receive the earnings of the road until the mortgagee takes possession.[43] Thus the Des Moines Valley Railroad Company executed to trustees a mortgage of its road, property and franchises, "together with the tolls, rents and profits, to be had, gained or levied therefrom." The mortgage provided that, after default continued for a certain period, the trustees might enter and take possession, but that until such time the mortgagor should have

[41] Coe v. McBrown, 22 Ind. 252.

[42] Coe v. McBrown, 22 Ind. 252.

[43] Merchants' Bank v. Petersburg R. 24 Pitts. L. J. (Pa.) 192; 12 Phila. (Pa.) 482; Sage v. Memphis &c. R. Co. 125 U. S. 361, 8 Sup. Ct. 887; Fosdick v. Schall, 99 U. S. 235, 253; Galveston R. Co. v. Cowdrey, 11 Wall. (U. S.) 459; American Bridge Co. v. Heidelbach, 94 U. S. 798; Teal v. Walker, 111 U. S. 242, 4 Sup. Ct. 420; Mercantile Trust Co. v. M. K. & T. R. Co. 36 Fed. 221, 1 L. R. A. 397n; Dow v. Memphis &c. R. Co. 124 U. S. 652, 8 Sup. Ct. 673, 30 Fed. 768, 33 Am. & Eng. R. Cas. 12; Life Asso., In re, 96 Mo. 632, 10 S. W. 69; Mercantile Trust Co. v. Baltimore & O. R. Co. 94 Fed. 722.

Where the mortgage does not convey the income or earnings, but only authorizes the trustee to take possession in case of default, the trustee could only secure the earnings by taking possession. United States Trust Co. v. Wabash R. Co. 150 U. S. 287, 14 Sup. Ct. 86.

the sole right of possession, use and management of the mortgaged premises. The mortgagees subsequently commenced a suit to foreclose the mortgage, but did not take possession of the property or ask for the appointment of a receiver to the suit. Pending the suit a creditor of the company obtained judgment against it, and attached as garnishee an agent of the company who had money belonging to it received from the sale of passenger tickets and for freight charges. A receiver was subsequently appointed in behalf of the mortgagees, who also claimed the funds attached in the hands of the agent and received by him before the appointment of the receiver. The Supreme Court of the United States adjudged that the mortgagees had no right to the earnings of the road until they took possession through the receiver.[44]

The same question had previously been passed upon by the Supreme Court of the United States in the case of *Galveston R. R. Co.* v. *Cowdrey*.[45] The mortgages conveyed the road and other corporate property, and all tolls, issues and profits, whenever default should be made in paying the bonds; but they provided that so long as no default was made in payment of principal or interest the property should remain in the company's possession; but if it should be in de-

[44] Gilman v. Illinois &c. Co. 1 McCrary 170, 91 U. S. 603, 617.

"Possession," said Mr. Justice Swayne, delivering the opinion of the court, "draws after it the right to receive and apply the income. Without this the road could not be operated, and no profit could be made. Mere possession would have been useless to all concerned. The right to apply enough of the income to operate the road will not be questioned. The amount to be so applied was within the discretion of the company. The same discretion extended to the surplus. It was for the company to decide what should be done with it. In this condition of things the whole fund belonged to the company, and was subject to its control. It was, therefore, liable to the creditors of the company as if the mortgages did not exist. They in no wise affected it. If the mortgagees were not satisfied, they had the remedy in their own hands, and could at any moment invoke the aid of the law, or interpose themselves without it." See also Gibert v. Washington City &c. R. Co. 33 Gratt. (Va.) 645, 649. The same rule applies to other corporations. Lehman v. Tallassee Mfg. Co. 64 Ala. 567; Frayser v. Richmond &c. R. Co. 81 Va. 388, 10 S. W. 69; Life Association, In re, 96 Mo. 632; Freedman's Sav. Co. v. Shepherd, 127 U. S. 494, 8 S. Ct. 1250. See also Hook v. Bosworth, 64 Fed. 443.

[45] 11 Wall. (U. S.) 459.

fault for the space of three months in payment of either, and on request in writing by any holder of the bonds, the trustees might take actual possession of the road, and, after notice, sell the same. The trustees claimed that they were entitled under the mortgage to the tolls and income received by the purchasers of the road during the time it was operated by them after default and before possession was taken under the mortgage; but the court were of opinion that the clause of the mortgage providing for the taking of possession under it pointed out the manner in which the pledge of the tolls and income was to be practically carried into effect; and they held that at any rate, until a regular demand for the tolls and income was made, the purchasers in possession of the road were not accountable for them.

Again, in still more recent cases, the Supreme Court of the United States has reiterated its decision that a pledge of rents and profits can be made available to the mortgagee only upon his taking possession himself, or having a receiver appointed and put in possession.[46] The mortgage in this case included, besides the bridge, "the rents, issues and profits of said bridge, as far as the same are not required to pay the necessary expenses of keeping in repair and operating said bridge, which rents, issues and profits * * * are hereby pledged to the payment of said interest as it matures." It was further provided that after default for a certain period the mortgage trustees might take possession. A judgment creditor of the bridge company claimed priority of payment out of money in its possession, and out of rents due to it from a railroad company, while the mortgage trustees sought to have these funds applied upon the mortgage; but the court held that inasmuch as the trustees had not taken possession, they were no more entitled to these funds than they would be to property that was never within the scope of the mortgage. Of course, after the trustees under such a mortgage have taken possession, the earnings belong to them and are no longer subject to garnishment.[47]

Under such a mortgage, also, it seems that after specific income of a road has been set apart by the corporation for the payment of

[46] American Bridge Co. v. Heidelbach, 94 U. S. 798, 4 Cent. L. J. 367, citing and approving Galveston R. R. v. Cowdrey, 11 Wall. (U. S.) 459; Gilman v. Illinois &c. Tel. Co. 91 U. S. 603; Dow v. Memphis &c. R. Co. 124 U. S. 652, 8 Sup. Ct. 673.

[47] Galena & Chicago Union R. Co. v. Menzies, 26 Ill. 121.

interest on its bonds, and as a sinking fund for their redemption, by agreement with the mortgagees, although in advance of the earning of the money, it is not subject to attachment by a creditor of the corporation. Such income is in that case specifically pledged to the use of the bondholders, and becomes theirs as soon as it is earned.[48]

§ 81. **If a lease is executed after the making of a mortgage, the mortgagee cannot claim the rents without the lessee's consent,** either before or after the mortgagor's default. The mortgagee cannot, without an attornment to him by the lessee, demand the payment of rent by the lessee, nor enforce the covenants and provisions of the lease. His remedy is, upon default, to foreclose his mortgage, or to take possession of the property. He thereby places himself in position to obtain the future rents. The lessee is thereby left at liberty to terminate the lease and quit, or to attorn to the mortgagee.[49]

§ 82. **A mortgagee is not entitled to the net earnings of the property while it is in the hands of a receiver appointed in behalf of a judgment creditor,** when the mortgagee has made no demand for such earnings under the provisions of the mortgage, even although the judgment creditor in his suit has expressly sought relief subject to the mortgagee's rights. Neither the bondholders nor their trustees, pending the receivership, asked that the receiver should, from and after their appearance in the suit, hold for them as well as for the judgment creditor. They did not, prior to the termination of the receivership, choose to assert their lien.[50]

Under a statutory provision that a mortgage can lawfully embrace only property in possession, or to which the mortgagor has the immediate right of possession, an income being necessarily in the nature of a future acquisition, cannot be mortgaged without express legislative authority. Consequently in a contest over a fund in court between a mortgagee of future income and a prior judgment creditor of the mortgagor, the judgment is entitled to payment in preference to the bondholders' claim,[50*] because the judgment is a valid lien

[48] Galena & Chicago Union R. Co. v. Menzies, 26 Ill. 121.

[49] Jones Mortg., §§ 776–778; Moran v. Pittsburgh &c. R. Co., 32 Fed. 878.

[50] Sage v. Memphis &c. R. Co. 8 Sup. Ct. 887.

[50*] Georgia &c. R. Co. v. Barton, 101 Ga. 466, 28 S. E. 842; Lubroline Oil Co. v. Athens Bank, 104 Ga. 376, 30 S. E. 409; Veatch v. American &c. T. Co. 84 Fed. 274.

on the property of the railroad, not capable of enforcement by levy but capable of being made effectual by appropriate equitable decree.

§ 83. **The earnings of a railroad company, before foreclosure or possession taken by the trustee, are liable to garnishment,** although included in a previous mortgage, where this provides that until default the company may possess and use the road, and receive the rents and profits arising from it.[51] Thus the Mississippi Valley and Western Railway Company conveyed[52] its "rights, powers, franchises, emoluments, income and property" to trustees by a mortgage, which provided that after a default continued for six months it should be the duty of the trustees, upon request of a certain portion of the bondholders, "to enter forthwith upon the railroad property," and to use and operate it until all overdue coupons should be paid, or until the road and its property should be sold pursuant to the power in the mortgage, or under a decree of court; but until default the company is to possess and use the road and property, and receive the rents, profits and income arising therefrom. Earnings of the company in the hands of the United States Express Company were attached by garnishee process, whereupon the mortgage trustees interpleaded, claiming the amount due from the express company as belonging to them under the mortgage. The court, however, was unable to discover an intention to vest a right to the income in the trustees, until default in the condition and possession taken by the trustees. While it is the duty of the railroad company to apply the income, after payment of current expenses, including necessary repairs and improvements, to the liquidation of the interest due upon its bonds, "this obligation, of its own force, no more carries title to the particular money received as income to the bondholders or trustees than does the obligation to pay a debt, in ordinary cases, carry title to the creditors of the money in the debtor's pocket. The fact that the mortgagor is in possession, operating the road, renders it indispensable that he shall pay current expenses, and necessary repairs and im-

[51] Smith v. Eastern R. Co. 124 Mass. 154; Ellis v. Boston, Hartford & Erie R. Co. 107 Mass. 1; Bath v. Miller, 51 Me. 341, 53 Me. 308; Noyes v. Rich, 52 Me. 115, overruling Woodman v. York &c. R. Co. 45 Me. 207; Merchants' Bank v. Petersburg R. 34 Leg. Int. 240; De Graff v. Thompson, 24 Minn. 452.

[52] Mississippi &c. R. Co. v. U. S. Express Co. 81 Ill. 534, 537.

provements, and that he shall exercise his judgment and discretion as to the extent repairs and improvements shall be made; and this can only be paid out of the income. It is inconsistent with such control over the income that it shall be the property of the trustees."

The views of the court in this case were grounded upon the common-law rule that the mortgagor is not required to account to the mortgagee for rents and profits while he remains in possession.[53] The railroad company was incorporated by acts of the legislatures of the states of Iowa and Missouri, and its road was located in those states, although its cars were also run over the bridge which crosses the Mississippi River at Quincy, and into the state of Illinois. It was insisted, therefore, that comity required that the court should follow the construction of this question given by the Supreme Court of Iowa, which had decided that the income of a railroad under such a mortgage belongs to the trustees, and could not be reached by process of garnishment at the instance of creditors.[54] But the court of Illinois declined to follow the ruling in Iowa, on the ground that comity in no case required the court to follow other than what it regarded as the clearly established law of the foreign jurisdiction with reference to the contract to be affected by it. Here the contract was affected by the laws of two foreign jurisdictions. Neither is superior to the other. While the law of Iowa was known to the court, that of Missouri was not; therefore the case was regarded as one in which the obligations of interstate comity, in the application of the law, cannot be appealed to, and the court must follow that construction which it believes to be authorized by law.[55]

§ 84. **At law a railroad mortgage cannot be made to operate upon the future earnings** of the road as against attaching creditors of the company. The European and North American Railway Company executed a mortgage of "all its right, title and interest in and to all and singular its property real and personal, of whatever nature and description, now possessed, or to be hereafter acquired, including all its rights, privileges, franchises and easements." Subsequently it entered into a contract with the Eastern Express Company to carry their freight for five years at a stipulated price, to be paid

[53] Jones Mortgages, § 670; Moore v. Titman, 44 Ill. 367, 371; Lehman v. Tallassee Mfg. Co. 64 Ala. 567.

[54] Dunham v. Isett, 15 Iowa 284.

[55] Mississippi &c. R. Co. v. United States Exp. Co. 81 Ill. 534.

in monthly installments. Upon the first day of November, 1875, the express company became indebted to the railroad company for a month's service under the contract. On that day the express company was summoned as trustee of the railroad company. The trustee under the mortgage took formal possession of the road on the twenty-seventh day of October preceding, for condition broken. He claimed the monthly payment in the hands of the express company, as covered by the mortgage. The Supreme Court of Maine[56] decided against this claim. They regarded the contest as one where legal and not equitable rules are to prevail, the action being at law. The contract with the express company did not exist at the time of the mortgage, even if this could be held to include it under the general terms of the description. At law, therefore, the contract was not assigned by the mortgage. Neither does it come within any of the modifications of the common law principle that a conveyance cannot be made of what does not at any time exist. Such a contract is not accessory to the road or its franchises, or any of the property. Moreover, even in equity an assignment of claims not then existing, to be upheld, must be of such claims as both parties expected would exist. In conclusion the court say that the portion of the fund earned before the trustee took possession cannot be regarded as any part of the property mortgaged, but rather the earnings derived from the use of such property by the mortgagor in possession. The trustee is entitled to the earnings of the road from the time he took possession, and therefore the monthly payment should be apportioned and the trustee charged for the part earned at the time the trustee took possession.

§ 85. **Only the net income of the road, after the payment of all expenses,** so long as the mortgagors remain in possession, is covered by a mortgage of all the tools, income, rents, issues and profits of a railroad, which also provides that upon default the mortgagees may take possession, work the road and apply the net income to the payment of the debt, but that until default the mortgagors shall remain in possession. Therefore the railroad company, while in the possession and management of the road, may contract for such articles as enter into the expense of maintaining and operating the road, and a creditor furnishing such articles may attach, by trustee or garnishee process, tolls due to the mortgagors from another corporation.[57]

[56] Emerson v. European &c. R. Co. 67 Me. 387, 24 Am. R. 39.

[57] Parkhurst v. Northern Central R. Co. 19 Md. 472, 81 Am. Dec. 648.

A mortgage made by the Virginia and Tennessee Railroad Company conveyed its property *in esse,* and all it might afterward acquire, with all tools, issues and income, and provided that the company might remain in possession until default, and should have the right to apply any of the money or personal property of the company to the construction or repair of the road or to its current expenses, or the payment of debts; and moreover should have the right, after deducting from the net profits an amount sufficient to pay the interest on its bonds, and to lay aside a sinking fund of one per cent. upon the amount of the bonds, to distribute the balance in dividends; and further, that in case of default, the trustees should take possession of the road and use the same according to the rules and regulations and lawful directions of the president and directors. Before default a creditor, whose debt was properly chargeable to the expense account, attached tolls belonging to the road. The Supreme Court of Tennessee held that inasmuch as the creditor had attached the tolls before they came to the hands of the trustees, and before any default had occurred in the payment of the bonds or interest, and while the road remained in the hands of the company, he acquired a lien superior to that of the mortgage. The receipts of the road were not regarded as coming under the mortgage lien until the net profits had been ascertained.[58]

So long as mortgage trustees or the bondholders omit to take possession of the mortgaged property after a default, they cannot complain that the income of the road is applied to completing and operating the road, and to the payment of floating debts.[59]

See Sheaff's App. 55 Pa. St. 403 for a similar case of a mortgage of tolls and profits by a navigation company.

[58] Clay v. East Tennessee &c. R. Co. 6 Heisk. (Tenn.) 421.

"This, we think, is the plain meaning of the stipulations of the deed. To construe the deed as intending to fasten the lien of the mortgage on the gross earnings would result in depriving the company of appropriating them to the current expenses of the road, and effecting the objects and purposes of the deed itself. The mortgagees look to the net earnings of the road for the payment of their interest and their bonds. They agree that the company shall operate the road, in order that net profits may be produced. To enable them to do this, they leave in the hands of the company the gross earnings, to be used in meeting current expenses and debts."

[59] Williamson v. New Albany F. Co. 1 Biss. (U. S.) 198.

§ 85a. **The "net earnings" described in a mortgage** given by a lessee railroad, of the net earnings of all business coming to it over the lessor road in consideration of the lease of the road, are ascertained by deducting from the gross receipts of such business its proportional share of the expenses of operating the entire road. Such a mortgage of the net earnings of all business coming to the lessee road "from or over" the lessor road covers the earnings of business carried in both directions.[60]

§ 86. **Money in the hands of the treasurer of a railroad company at the time possession is taken,** under a mortgage covering its property and earnings, belongs to the corporation and not to the trustees, in case the mortgage provides that until default the company may retain possession; and if the trustees take possession of this money, inasmuch as it is not subject to the lien of the mortgage, it is subject to garnishment at the suit of judgment creditors of the company. The mortgage of the St. Paul and Pacific Railroad Company covered the road and franchises, and "the tolls, incomes, rents, issues and profits." It provided that until default in payment of the principal and interest of the bonds secured, the company was to operate the road and use the rents and profits as if the mortgage had not been made; but that, in case of default, the trustees might enter into possession, collect and receive all tolls and freights and operate the road for the benefit of the bondholders. When the trustees under the mortgage took possession of the road, they also took possession of a considerable sum of money then in the treasurer's hands, and soon afterwards were summoned in a garnishee process by judgment creditors of the company, who claimed that the funds were subject to their judgment debt. This money or debt, said the court, was the subject of garnishment, unless the trustees had the right to take and hold it by virtue of some lien created by the mortgage. Whenever, by the terms of a mortgage upon this kind of property, either expressly or by implication, the right is reserved to the mortgagor company, who is the general owner, to retain the possession and use of the mortgaged property, by operating the road, receiving the earnings, and applying them in its discretion towards defraying the operating expenses, such mortgagor must be regarded as the owner of all such earnings acquired by the continuance of its possession, and as invested

[60] Schmidt v. Louisville C. & L. R. Co. 112 Ky. 717, 25 S. W. 494.

with the absolute right of disposal as fully as any general owner of property enjoys. This right is wholly inconsistent with the exercise of any specific lien under the mortgage in favor of the mortgage trustees.[61]

Though the mortgage uses the word "moneys" in connection with "income, earnings," etc., the word does not enlarge the rights of the mortgagee, so as to convey to him such moneys of the company as are simply past income and earnings.[62]

Money in the hands of a station agent of a railroad company, received for tickets sold and freight collected, cannot be attached in his hands by trustee process in a suit against the company by a creditor. Such an agent is considered as the corporation itself in such business. There may be a limit to the application of this principle. There may be an agent of such a corporation who is not invested with its personality. But all regular agents doing the business for which the corporation was organized must be considered as identical with the corporation, and their possession as the possession of the company.[63] Therefore they cannot be held as its trustees.

Funds in the hands of a treasurer of a railroad company at the time of its making a trust mortgage of all its property, and embraced in the mortgage, cannot be held by creditors by means of a trustee process, although the mortgage trustees have permitted the company to use and manage the road and its other property.[64]

A similar decision has been made by the Supreme Court of Tennessee, which in a recent case held that, under a mortgage covering the income of a railroad, the earnings of the road in the hands of the treasurer are not subject to attachment when this is made subsequently to the registration of the trust deed.[65]

§ 87. A mortgage of the tolls and income of a railroad has, however, been enforced against the mortgagor for the income received by him while in possession, under a mortgage quite similar in terms

[61] De Graff v. Thompson, 24 Minn. 452, 5 Reporter 561; and see Merchants' Bank v. Petersburg R. 24 Pitts. L. J. (Pa.) 192, 5 Cent. L. J. 74; Sprague v. Steam Navigation Co. 52 Me. 592.

[62] Dow v. Memphis &c. R. Co. 20 Fed. 768.

[63] Pettingill v. Androscoggin R. Co. 51 Me. 370; Fowler v. Pittsburgh &c. R. Co. 35 Pa. St. 22.

[64] Woodman v. York &c. R. Co. 45 Me. 207; and see Noyes v. Rich, 52 Me. 115. See § 87.

[65] Buck v. Memphis &c. R. Co. March T. 1877, 4 Cent. L. J. 430.

to those already mentioned.[66] In 1848 the legislature of Indiana chartered a company to make a railroad from Richmond to New Castle, in that state, a distance of twenty-seven miles. In 1851 the charter was amended so as to enable the company to extend its road, and to borrow money on a mortgage of its "road, income and other property." In 1852 the company issued its bonds to the amount of $300,000, payable in fifteen years, and secured them by a mortgage of "all the present and future to be acquired property of the said The New Castle and Richmond Railway Company; that is to say, the first section of their road from Richmond to New Castle as aforesaid, with the superstructure, and all rails and other materials used therein, and all rights therein, tolls and income, and any rights thereto or interest therein, together with the tolls or income to be had or levied therefrom, and all franchises, rights and privileges of the said The New Castle and Richmond Railroad Company of, in, to, or concerning the same."[67] The mortgage provided that the trustees named in the deed, upon default of the company to pay either interest or principal of the bonds, might enter and take possession of the mortgaged property, and use the same, and apply the proceeds of such use to the payment of the principal and interest of the bonds; and that, if it should become necessary, the trustees might sell the mortgaged property at auction and apply the proceeds to the payment of the principal and interest. Other mortgages were afterwards made of the whole line of road from Logansport to Richmond, a distance of one hundred and eight miles; and under one of these mortgages the property was sold, subject to the above mortgage, and was purchased by the Cincinnati and Chicago Air Line Railroad Company, which took possession of the road on the first day of July, 1860. In 1864 a bill was filed in the circuit court of the United States to foreclose the mortgage of 1852, upon which neither principal nor interest had been paid. Litigation upon this bill was continued until 1873, when the case was finally disposed of.[68] During this long period much had

[66] Pullan v. Cincinnati &c. R. Co. 5 Biss. (U. S.) 237. See also 4 Biss. (U. S.) 35, and Bill v. New Albany R. Co. 2 Biss. 390. From the facts of the case as they appear in these reports, it seems that the decision is not in accordance with general principles or general authorities.

[67] Pullan v. Cincinnati &c. R. Co. 4 Biss. (U. S.) 35. "Such is the verbose language of the deed," per McDonald, J.

[68] Pullan v. Cincinnati &c. R. Co. 5 Biss. (U. S.) 237.

occurred in the progress of the case; many orders had been made by the court; and, among others, an interlocutory decree by Mr. Justice Davis in 1869, which found that the mortgage of 1852 covered the railroad and its revenues between Richmond and New Castle, but not the road or income of any other part of the road; and that it covered a ratable portion of the rolling stock, or one-fourth part of it, that being the relative length of this portion of the road to the length of the whole line of road.

One of the principal questions to be determined upon final hearing was whether the mortgage covered the income which had in the mean time been secured from this section of the road. The interlocutory order of Judge Davis declared the plaintiff entitled to the income from the date of the filing of the bill in 1864. It does not appear why that date was fixed upon, unless it was considered that the filing of the bill was a demand for the earnings. In 1872, however, the master was authorized to take an account of the earnings of the road from the first day of July, 1860, when the defendant company took possession of the road; and he found that from that date up to the beginning of the suit the income amounted to $95,344.08, and the questions of the right to the income and of the time for which it should be taken became of importance. The court held that the mortgagee was entitled to the income from the time the defendant took possession of the road; that, notwithstanding the general rule that the mortgagor, until some action by the mortgagee, is entitled to the earnings and profits of the mortgaged property, it is competent for the parties to agree in the mortgage that such earnings and profits shall be subject to the lien, and that under such agreement the income, when received, is held by the party receiving it in trust for the mortgagee. It was claimed by the defense that the defendant company would certainly not be chargeable with any income after it had offered in open court to deliver up and surrender to the plaintiff the property covered by the mortgage. To this the court replied, that the mortgage took effect upon the income when earned; and as long as the mortgagor or its assignee operated the road and earned income, the responsibility growing out of these facts could not be avoided. The court further suggested, but did not decide, that although the mortgage in this case covered only the section between Richmond and New Castle, as it included the income of this section, and the company in possession operated the whole road as an entirety and kept no separate accounts

of that section, its whole property and interest in the road might be equitably bound for any decree for such income that might be rendered against it.

In Iowa it has also been held that it is competent for a railroad company to mortgage its future net earnings, although the road be not *in esse* at the time of the execution of the mortgage; and when such earnings have accrued, a creditor cannot intercept them in the hands of the servants of the company.[69]

The Mississippi and Missouri River Railroad Company, incorporated under the laws of Iowa, executed a mortgage of its road and property, together with "all the tolls, incomes, issues, and profits to be had from the same." The mortgage provided that "all of the rights of the bondholders or trustees are subject to the possession, control, and management of the directors of said company until default." The earnings of the road subsequently proved insufficient to pay the ordinary operating expenses and the interest on the bonds. A judgment creditor of the company attempted to reach and apply to the payment of his demand credits of the company for freight and other earnings in the hands of several persons. The supreme court of Iowa held, however, that the revenues of the company were not subject to attachment or execution, and that a creditor attempting so to apply them might properly be restrained by a court of equity.[70] This case contains no discussion of the question, and the authority cited[71] is not applicable, because the moneys sought to be held in that case were earned after the mortgagees took possession.

§ 88. **In estimating the earnings of a section of a road covered by a mortgage, the master may make a pro rata estimate of the earnings** and expenses of the whole road, when such section has not been operated separately, but as a part of the whole road, and no separate accounts have been kept of that part. Under such circumstances the master could not probably adopt any other rule, and although the result is not an accurate one, it is the best that could be reached. A railroad company, after neglecting to keep separate accounts for such section, cannot be heard to complain of the adoption of this rule.[72]

[69] Jessup v. Bridge, 11 Iowa 572, 79 Am. Dec. 513; Dunham v. Isett, 15 Iowa 284.

[70] Dunham v. Isett, 15 Iowa 284.

[71] Galena &c. R. Co. v. Menzies, 26 Ill. 121.

[72] Pullan v. Cincinnati &c. R. Co. 5 Biss. (U. S.) 237. See this case

§ 89. **A railroad company may be enjoined from misapplying its income** as against an income mortgage. If, upon an application for such injunction, the company relies on a bare denial of the charge of misapplication, and gives no figures from which the condition of its business or the manner of disposing of its earnings can be determined, and no explanation of a very great shrinkage of its net earnings, the injunction will be allowed though the charge is in part on information and belief.[73]

§ 90. **A lessor railroad company may mortgage the rent charge which it has upon the leased road.** The lessor's interest being a fixed rent arising from the use of the leased road by the lessee, and a right to compel the lessee to apply the income to the extinguishment of such rent, with a further right to enter and take possession in case of a default, is susceptible of valuation and alienation like other property, and bonds secured by mortgage may be issued on the security of such property.[74]

for methods of estimating the net earnings of a section of a road, the rental value of rolling stock, and the like.

[73] Barry v. M. K. & T. R. Co. 36 Fed. 228, 36 Am. & Eng. R. Cas. 332.

[74] Langdon v. Vermont &c. R. Co. 54 Vt. 593; Hazard v. Vermont & C. R. Co. 17 Fed. 753.

CHAPTER IV.

MORTGAGES OF AFTER-ACQUIRED PROPERTY.

I. Principles upon which after-acquired property may be charged, §§ 91–98.
II. What terms are sufficient to include after-acquired property, §§ 99–113.
III. Mortgages attach to after-acquired property subject to existing liens, §§ 114–120.

I. *Principles upon which After-acquired Property may be charged.*

§ 91. After-acquired property at law. "It is a common learning in the law," says Perkins,[1] "that a man cannot grant or charge that which he hath not." *Qui non habet, ille non dat.* Yet even at law this rule is not without some qualifications. Many instances of accessions and increase of property passing with a grant are given in the old books. Then, coming to the doctrine of fixtures, there is no doubt entertained as to the proposition, that at law a mortgage of land will pass all structures and things attached to it in the nature of fixtures that may be placed upon it by the mortgagor. But according to the doctrine of some cases, it is not necessary to maintain that the rolling stock and equipments of a railroad are parts of its accretions and fixtures to make a mortgage of them good at law. Such a mortgage, whether good at law or not, is held good in equity.

At law, an agreement to create a lien, either upon property in possession at the time or upon that which may be acquired afterwards, must have reference to specific property, which must be defi-

[1] A Profitable Book, tit. Grants, § 65.

nitely and intelligibly pointed out. But this description may be made in general terms. A mortgage of all lands which the mortgagor might afterwards acquire would create no specific lien upon any land, but would be merely an executory contract binding upon the mortgagor personally.[2]

§ 92. In equity it is common learning that a covenant for a valuable consideration to convey particular lands is deemed a specific lien upon those lands, which will be enforced against the covenantor and all persons claiming under him, except purchasers for value without notice of such covenant.[3] Equity considers that done which one has distinctly agreed to do, and is in conscience bound to do. Equity, therefore, treats a mortgage of things not *in esse* as a contract which attaches itself to the things when they come into being, and enforces it. Upon the principle, that upon every acquisition of property within the description contained in the mortgage a chancellor would decree the mortgagor to execute a mortgage of such subject, it will be considered as though it had been done, and that of every article of property as acquired, there was an actual mortgage then executed.[4] That a contract by way of mortgage intended by the parties to create a positive lien or charge either upon real or personal property, whether owned by the mortgagor or not, or, if personal property, whether it is then in being or not, attaches in equity as a lien or charge upon the particular property as soon as the mortgagor acquires title thereto, is a proposition that is almost universally supported by recent authorities, both English and American.[5] A conveyance of what does not exist does not operate

[2] See Winslow v. Merchants' Ins. Co. 45 Mass. 306, 316, per Shaw, C. J.

[3] Fonblanque, b. 1, Ch. 5, § 8; Freemoult v. Dedire, 1 P. Wms. 429.

[4] Per Mr. Justice Sharswood, Philadelphia, &c. Co. v. Woelpper, 64 Pa. St. 366; 3 Am. R. 596; Covey v. Pittsburgh, F. W. &c. Co. 3 Phila. (Pa.) 173, per Agnew, P. J.; Little Rock &c. R. Co. v. Page, 35 Ark. 304; Quincy v. Chicago &c. R. Co. 94 Ill. 537; Poland v. Lamoille &c. R. Co. 52 Vt. 144; Hodder v. Kentucky &c. R. Co. 7 Fed. 793, per Barr, J.

[5] Holroyd v. Marshall, 10 H. L. Cas. 191; Pennock v. Coe, 23 How. (U. S.) 117; Mitchell v. Winslow, 2 Story (U. S.) 630, 644; Brett v. Carter, 2 Lowell (U. S.) 458; Barnard v. Norwich &c. R. Co. 4 Cliff (U. S.) 351; 14 N. Bank, Reg. 469; Dillon v. Barnard, 1 Holmes

as a present transfer in equity any more than it does in law. The difference is merely that at law the conveyance, having nothing to operate upon, is void; while in equity what is in form a conveyance operates, by way of present contract, to take effect and attach to the subject of it as soon as it comes into being; the agreement to convey then ripens into an actual transfer.[6]

A mortgage of after-acquired property, being a specific lien, and good in equity, is preferred to a subsequent legal lien by judgment or mortgage.[7] With greater reason, therefore, a mortgage of after-acquired property would be preferred to a subsequent equitable lien by way of mortgage. It has been held not to affect this rule that the mortgagor delivers the mortgage *res* into the hands of the second mortgagee.[8]

In Louisiana, a mortgage does not extend to property acquired after the date of it.[9] The Civil Code provides that future property cannot be the subject of a conventional mortgage.[10]

§ 92a. **In Massachusetts, a covenant or agreement in a chattel mortgage in regard to after-acquired property** will become effectual for the security of the mortgagee if he takes and keeps possession of the property under his mortgage, but not otherwise. In a case where a mortgage by a corporation had been made to a trustee to secure an issue of bonds, the trustee was a corporation which became insolvent and was placed in the hands of a receiver. A bill in equity was brought by bondholders to have a new trustee appointed

(U. S.) 386, 394; Williamson v. New Jersey &c. R. Co. 29 N. J. Eq. 311; 15 Am. Railway, 572; Butler v. Rahm, 46 Md. 541; Cook v. Corthell, 11 R. I. 482; 23 Am. R. 518, dissenting opinion; Morrill v. Noyes, 56 Me. 458; Buck v. Seymour, 46 Conn. 156; Parker v. New Orleans &c. R. Co. 33 Fed. 693; Bell v. Railroad Co. 34 La. Ann. 785; Boston &c. Co. v. Bankers' &c. Co. 36 Fed. 288; Central Trust Co. v. Kneeland, 138 U. S. 414.

[6] Emerson v. European &c. R. Co. 67 Me. 387.

[7] Stevens v. Watson, 4 Abb. App. Dec. (N. Y.) 302; and see Dwight v. Newell, 3 N. Y. 185; But see Adamant Plaster Co. In re, 137 Fed. 251.

[8] Central Trust Co. v. West India Imp. Co. 169 N. Y. 314; 62 N. E. 387.

[9] State v. New Orleans & Nashville R. Co. 4 Rob. (La.) 231; State v. Mexican &c. R. Co. 3 Rob. (La.) 231, 513.

[10] 2 Rev. Code 1870, art. 3308.

and to have a receiver appointed for the mortgagor corporation. It was contended that there was at that time nobody legally qualified to take possession of the after-acquired property as mortgagee. "Whether that be so or not," said the court, "if a bill had been brought for the purpose of acquiring possession of this property in the interest of the bondholders, it might well be that the possession of a receiver subsequently appointed in the case would give effect to the provisions in the mortgage in regard to the after-acquired property; but there is nothing in the original bill to show that the plaintiffs were proceeding with any such purpose. . . . There is no suggestion," continues the court, "that the rights of the bondholders depend upon any act done or to be done in regard to after-acquired property. The decree appointing the receiver is carefully guarded to protect the title and rights of the parties as they were when the bill was brought. At that time the mortgagee had acquired no title to the after-acquired property, but it was subject to the claims of the creditors, or of an assignee in insolvency if one should be appointed."[11]

§ 93. **A railroad company having authority to mortgage its corporate property and franchise may include in the mortgage after-acquired property,** without exceeding the limits of its power."[12] "To build a railroad requires a vast capital beyond ordinary means, and to borrow it, 'to carry into effect the objects of the corporation,' demands all the security within the possible power of the corporation to give. By necessity and practice, the money of the creditor capitalist finishes and equips the road; and slender indeed would his security be which extends not beyond the worn-out rails and rolling stock and equipment first in use, and these, indeed, not often in being at the time of the execution of the mortgage. In giving the

[11] Harriman v. Woburn &c. Light Co. 163 Mass. 85; 39 N. E. 1004, per Knowlton, J.

[12] Dunham v. Cincinnati & Peru R. Co. 1 Wall. (U. S.) 254; Kelly v. Alabama &c. R. Co. 58 Ala. 489; Hamlin v. E. & N. A. R. Co. 72 Me. 83; Central Trust Co. v. Chattanooga &c. R. Co. 94 Fed. 275; Compton v. Jessup, 68 Fed. 263. Such power is conferred upon railways by express statute in Georgia. McTighe v. Macon Const. Co. 94 Ga. 306; 21 S. E. 701; 32 L. R. A. 2083; Hawkins v. Mercantile Trust Co. 96 Ga. 580; 23 S. E. 498.

power to borrow and pledge, it must be supposed the power was given to its fullest extent in order to carry into effect the objects of the incorporation."[13]

A company empowered to borrow money on the security of its property and income is authorized to mortgage every species of property necessary to the operating of the road, whether then owned by it or afterwards acquired.[14] Such a mortgage covers a completed road afterwards purchased, if such road was within the chartered limits of the company, and might have been constructed if it had not been purchased.[15] The rule applies more clearly to personal property afterwards attached to the mortgaged road, or purchased for its use.

The Philadelphia and Baltimore Central Railroad Company, in pursuance of authority given by charter, executed a mortgage to trustees of all their corporate property and franchises then held or thereafter to be acquired, to secure their bonds, not exceeding $1,500,000 in amount. The mortgage also provided a mode by which the whole mortgaged property might be sold together by the trustees, at the request of bondholders, to the amount of $100,000. The Philadelphia, Wilmington and Baltimore Railroad Company, in a suit upon bonds secured by this mortgage, recovered judgment for $122,942.11 against the mortgagors; and an execution was issued which was levied upon four locomotive engines, a number of cars, shop and quarry tools, cross-ties, iron rails, and furniture at stations. Woelpper was the holder of bonds, secured by the mortgage, amounting to $7,200. He brought a bill in equity against the mortgagor and the judgment creditor, joining also the trustees under the mortgage, praying a decree that the property levied upon was a part of the mortgaged premises, and as such exempt from levy and sale under execution; and also that the judgment creditors be restrained from further levying the execution. The Philadelphia, Wilmington and Baltimore Railroad Company contended that the property levied on was not covered by the mortgage, because it was

[13] Per Agnew, P. J., in Covey v. Pittsburgh &c. R. Co. 3 Phila. (Pa.) 173.

[14] Ludlow v. Hurd, 1 Dis. (Ohio) 552; Coopers v. Wolf, 15 Ohio St. 523; Buck v. Seymour, 46 Conn. 156.

[15] Branch v. Jesup, 106 U. S. 468; 1 S. Ct. 175.

acquired after the delivery of the mortgage; but the court held otherwise, and perpetually enjoined them from levying the execution.[16]

§ 94. **It is not necessary to describe specifically the future property which it is intended the mortgage shall cover.** It is obviously impracticable to do this. All that is essential is that the mortgage shall show that it is intended to apply to after-acquired property of the mortgagor.[17]

Where a company is incorporated to construct a railroad between two cities, a mortgage upon its line of railroad, constructed and to be constructed, together with all the stations, depot grounds, etc., creates a lien upon its terminal facilities in those two cities. In

[16] Philadelphia &c. R. Co. v. Woelpper, 64 Pa. St. 366, 372; 3 Am. R. 596.

Authority given to a railroad company, by statute or charter, to mortgage "all or any part of the road, property, rights, liberties, and franchises of said company," gives the company the right to include in the mortgage all future accessions of the road. "Property," says Mr. Justice Sharswood, delivering the opinion of the Supreme Court of Pennsylvania in this case, "is whatever is a man's own. His future acquisitions, though subject to a contingency, are his own; and if, as we have seen, they can be granted or assigned, they are his present property, valuable now to him, because they can be enjoyed or used by anticipation. There is no refinement in this reasoning, as applied to the construction of this statute. The legislature evidently intended it. Every law is to be interpreted according to its subject matter. This act relates to a railroad and its usual necessary appurtenances. The words are 'road, property, rights, liberties, and franchises,' including the road and all its adjuncts. The very object of the loan, and of the mortgage to secure it, as expressed in the act, was 'for the purpose of constructing and equipping the road.' It evidently contemplated a condition of things in the future. The bare road, only then constructed in part, without any rolling stock or equipments, would have been no security, or a very inadequate one. Had the road even been fully equipped at the date of the mortgage, can it be doubted that the legislature meant that it should comprise everything subsequently acquired, to replace old and worn-out materials, and to maintain and keep up the equipment? No money would have been loaned on a security daily deteriorating, and which must eventually perish entirely." The learned judge quotes with approval the remarks of Mr. Justice Agnew, already given above.

[17] Parker v. New Orleans &c. R. Co. 33 Fed. 693.

the absence of restrictive words, such is the natural import, and therefore must be adjudged the intent and scope of the mortgage containing that description.[18]

§ 95. **A railroad with its franchises has sometimes been regarded as one entire thing,** a unity constituting one indivisible whole, so that a mortgage of it must necessarily embrace all property of every description essential for the use of the road; and must necessarily attach to all property subsequently acquired for its use, as an incident to the principal thing, although there be no language in the deed applicable in terms to such property.[19]

This doctrine, that the mortgage of a railroad as an entire thing covers parts of the thing which have been acquired or constructed after its execution, so far as it relates to such after-acquired property as actually becomes a part of the original thing mortgaged, rests upon the doctrine of accession, which prevails in ordinary mortgages where improvements are made upon real estate mortgaged which becomes a part of the realty, or where repairs are made on an article of personal property.[20]

The right of a railroad corporation to mortgage its after-acquired property is implied from any authority given it to mortgage its rights, franchises, and property as an entire thing; for, to be effectual, the mortgage must embrace all such future acquisitions of the corporation as are proper accessories to the thing pledged and essential to its enjoyment. In short, the power to mortgage after-acquired property is implied in the power to make any mortgage at all.[21] "Whatever is added to the original structure becomes a part of it, and cannot be severed from it; and if the security by the mortgage is to continue to be of any value during the period that must transpire before the bonds become due, it must depend upon the implied covenant of the company to keep it in running order,

[18] Central Trust Co. v. Kneeland, 138 U. S. 414; 11 Sup. Ct. 357.

[19] Dinsmore v. Racine &c. R. Co. 12 Wis. 649, 656; Parker v. New Orleans &c. R. Co. 33 Fed. 693.

[20] Farmers' &c. Co. v. Commercial Bank, 11 Wis. 207, 212, per Paine, J.

[21] Phillips v. Winslow, 18 B. Mon. (Ky.) 431; 68 Am. Dec. 729. See Pennock v. Coe, 23 How. (U. S.) 117; Shaw v. Bill, 95 U. S. 10, 16.

and thus earn the necessary sums to discharge the accruing interest, and, eventually, indemnify the creditors for the principal debt."[22]

§ 96. **This doctrine rests upon the authority of a few cases,** of which Pierce v. Emery[23] is perhaps the most important. The Portsmouth and Concord Railroad was authorized by the legislature of New Hampshire to issue bonds for a loan of money, and, for security, to make a mortgage to trustees of all the property and all the rights, franchises, powers, and privileges of the corporation, and in the mortgage to give the trustees power, on breach of the condition, to sell the real and personal estate, and all the rights, franchises, powers, and privileges named in the mortgage, by a deed which should convey to the purchasers all the rights, franchises, powers, and privileges which the corporation possessed, and the use of the railroad, with all its property and rights of property, for the same purpose and to the same extent that the corporation could use the same if the deed had not been made, subject to the same liability as to the use of the road that the corporation would have been under if it had continued in possession. The corporation issued bonds and made a mortgage under this authority, which conveyed the road and all its franchises and all the personal property of the company as it was then used, and as the same might thereafter be changed or renewed. After the making of the mortgage the company purchased a cargo of iron rails, and it being subject to a lien of the United States for duties, an agreement was made with certain parties that they should pay the duties and that the railroad might lay the iron on their track; but that the parties advancing the money might take up the iron and hold it for security for the money advanced, provided the company did not repay them within a specified time the money advanced. The court held that when this agreement was made the iron was already subject to the prior mortgage, and that all that the company could convey or deal with was an equity of redemption subject to that mortgage; that the iron having passed according to this bargain into the possession of the road, the

[22] Ludlow v. Hurd, 1 Dis. (Ohio) 552, 560, per Storer, J.

[23] 32 N. H. 484. See, however, Boston, C. &c. R. v. Gilmore, 37 N. H. 410; 72 Am. Dec. 336, and § 168.

lien for the duties was gone, and could not be asserted as against the mortgage.

As to the effect of this mortgage, the court regarded it as in substance a conveyance, under legislative authority, of the road and corporation as an entire thing, and that subsequently acquired property became a part of it as an incident and accession. Upon a sale of the property under the mortgage, all the rights and franchises of the corporation and the use of the road would be transferred to the purchasers, who would hold them subject to the same liabilities by which the corporation was bound before the sale.[24]

§ 97. The doctrine is not generally supported that after-acquired property of a railroad company passes, as incident to the franchise to acquire property, by a mortgage of the franchises and property of the company executed by lawful authority. This view was strongly urged upon the court in the case of Dinsmore v. Racine & Mississippi Railroad Company;[25] but the court, after examining the grounds of the doctrine and some of the cases supporting it, declined to adopt it, and stated the objections to it. It is true that at that time there was no statute in force in Wisconsin authorizing a railroad company to mortgage its franchises, and it is admitted that a cor-

[24] Pierce v. Emery, 32 N. H. 484, 512. Chief Justice Perley, delivering the opinion, said: "It is not easy to see how the original corporation, in the hands of the former corporators, could, after such a sale, have any practical or even legal and theoretical existence. They could hold no property; they could maintain no action, nor elect any corporate officer: these powers are all rights and franchises of the corporation, created and granted by the act of incorporation, and are all transferred and conveyed by the deed of the trustees to the purchasers under their sale. In some cases, after the franchises of a corporation are lost by forfeiture, the corporation is still held to exist in contemplation of law, so far as to be capable of being revived by a grant from the government. But here the franchises would not be forfeited to the state, but transferred to the purchasers; and the state could not revive the old corporation by a regrant of the franchises which had become vested in the purchasers. The sale would in substance transfer the road and the corporation to the purchasers."

[25] 12 Wis. 649. To same effect see Louisville Trust Co. v. Cincinnati Inclined Plane R. Co. 91 Fed. 699, citing text.

poration would have no power to make a mortgage by which property after acquired would pass as incident to the franchise to acquire property, except by virtue of express legislative authority to convey the franchises of the corporation. None of the cases which support this doctrine do so upon the general principle that a railroad, with its franchises and property, is an indivisible, entire thing, except as it becomes so by virtue of some special or general legislative authority.[26] On general principles of law, a railroad corporation, with its franchises and property, though undoubtedly having many things peculiar to itself, cannot be regarded as one entire and indivisible thing. It cannot be likened to a machine, or to a vessel. If a mortgage which does not in terms include after-acquired property can be held to embrace property which is personal in its nature, and is not attached to the realty as fixtures, without a special statute manifesting an intention on the part of the legislature that such mortgage should pass the entire franchises and property of the company, and without any general law giving to a mortgage made by a railroad company greater effect than is given to a mortgage by a natural person, a revolution would be worked in the registry laws.[27]

[26] See Pierce v. Emery, 32 N. H. 484; Phillips v. Winslow, 18 B. Mon. (Ky.) 431; 68 Am. Dec. 729; Willink v. Morris Canal &c. Co. 4 N. J. Eq. 377, 657.

[27] Dinsmore v. Racine & Miss. R. Co. 12 Wis. 649.

This objection is forcibly stated by Mr. Justice Cole, of the Supreme Court of Wisconsin: "If the mortgage of the Farmers' Loan and Trust Company became a prior lien upon the timber lands mentioned in this case, by virtue of the doctrine of entirety, there could be no safety in depending upon the record. For a person going to buy these lands of the railroad company would find nothing upon the record to apprise him that they had been mortgaged to that company. If he looked into that mortgage, he would find nothing in the description of the mortgaged premises which related to them. Finding the title of record in the railroad company unincumbered, so far as he could see, he might buy or take a mortgage upon the lands, trusting to the registry law. Thinking that the same legal consequences attached to a mortgage given by a railroad company as would attach to one given by a natural person, he would find that the record was but a snare. But still, if this is the settled law of the land in reference to railroads and railroad property, such a person could only complain of his ignorance and folly. This mortgage given the Farmers' Loan and Trust

§ 98. **This doctrine cannot be applied where several mortgages are given on separate divisions** of the road. The doctrine is based upon the ground that the property acquired after the making of a mortgage of the property and franchises of a railroad company passes as an incident to the franchise to acquire property. Such a mortgage, when duly authorized, is moreover regarded as a conveyance of the property and franchises of the company as an entire thing. A division of the franchise by a mortgage of a part of the road is impracticable.[28]

§ 98a. **The lien of bondholders is limited to such earnings only as shall accrue after the mortgage trustee or receiver shall have actually taken possession,** even though the mortgage in terms purports to include future-acquired property and income. The foreclosure of a corporate mortgage does not necessarily mean a sale of the property in the ordinary sense. It means simply a reorganization conducted by or in behalf of the bondholders. The property mortgaged is generally of such a character, and the debt of such magnitude, that a public sale in the ordinary sense is seldom practicable. "Whatever may be the real value of the property sold upon the foreclosure, there generally is and may always be a deficiency.

Company was made by virtue of the general power of the railroad company to dispose of its property, and not under any law of the state authorizing such corporations to mortgage their rights and franchises. If the mortgage had been made by an individual, within the decisions of this court, it would not have bound his subsequently acquired property. If the mortgage in this case embraced in its terms these timber lands, we might have to consider whether it did not fall within the principle of our decisions upon that subject; but it does not. The mortgage of the Farmers' Loan & Trust Company can only hold these lands by virtue of this doctrine of entirety. We have endeavored to show that in reason, and from the nature of railroad property, there is no ground for saying that a railroad, with all its rights, franchises, and property, real and personal, is an indivisible, entire thing. Practically, we believe, they are not so regarded. Mortgages are given upon the personal property of railroads, or upon some portion of it, or upon some portion of the real estate, or a portion of the road. The property has been treated as though it might be separated, and appropriated to the payment of debts, without destroying the integrity of the company."

[28] Farmers' &c. Co. v. Commercial Bank, 11 Wis. 207.

If the receiver under the mortgage can go back of his appointment and appropriate earnings of the corporation before his appointment and after the execution of the mortgage, in almost every case the only fund upon which the general creditor can rely for the payment of his debt may be absorbed by the bondholders, and this, too, although the receiver may have taken possession of or received the benefit of property furnished at their expense, and on the faith of the current earnings."[29]

II. *What Terms are Sufficient to include After-acquired Property.*

§ 99. The word "undertaking" may have the effect, whether by itself or in connection with other words, to create not only a charge upon the property itself of the corporation, as distinguished from its income merely, but also a charge upon after-acquired property. The circumstances of the case have much to do in determining the effect of the word. Thus, a steamship company having power to issue mortgages, bonds, or debentures, issued mortgage debentures, charging "the undertaking, and all sums of money arising therefrom," with the repayment of the loan. Before the maturity of these obligations the company was wound up, and the ships and other property of the company were sold. The court held that the debentures were a charge upon the property of the company, both that which existed at the time and that which was afterwards acquired.[30]

[29] New York S. & T. Co. v. Saratoga Gas & E. L. Co. 159 N. Y. 137; 53 N. E. 758; 45 L. R. A. 132, per O'Brien, J.

[30] In re Panama, N. Z. & A. Royal Mail Co. L. R. 5 Ch. App. 318–322; 4 Cox's Joint Stock Cas. 35.

Giffard, L. J., said: "I have no hesitation in saying that, in this particular case, and having regard to the state of this particular company, the word 'undertaking' had reference to all the property of the company, not only which existed at the date of the debenture, but which might afterwards become the property of the company. And I take the object and meaning of the debenture to be this, that the word 'undertaking' necessarily infers that the company will go on, and that the debenture holder could not interfere until either the interest which was due was unpaid, or until the period had arrived for the payment of his principal and

§ 100. **If a railroad company having the right by its charter constructs a branch road,** although this was not laid out at the time of the original location of the road, and was not then contemplated, nor was laid out or projected at the time of a mortgage of all the lands which might afterwards be acquired for the use of the road, such branch road and the land acquired for it, and for purposes connected with the use of the branch road, pass to the mortgagee.[31] Such branch road might, under some circumstances, be regarded as a legitimate incident of the main road, and as necessary for its use as are side tracks, shops, and engine houses.[32] If, however, the building of the branch road was not authorized at the time of making the mortgage, but was authorized by a subsequent charter giving other persons as well as the railroad company the right to become stockholders, the mortgage will not operate upon such branch road.[33]

§ 101. **When a railroad company has the right to change its location,** land acquired for its new location will be embraced in a mortgage previously made of all lands which it might afterwards acquire for the purposes of the road. Such land is sufficiently defined by reference to the charter of the road, which confers a privilege of changing its location within certain limits.[34] To hold that by deviating from the route laid down the road could be, *pro tanto*, freed from the lien, would be not only a violation of the terms of a mortgage covering all property to be acquired, but would be a very dangerous doctrine, and one contrary to public policy, which is, to

that principal was unpaid. I think the meaning and object of the security was this, that the company might go on during that interval; and, furthermore, that during that interval the debenture holder would not be entitled to any account of mesne profits, or of any dealing with the property of the company in the ordinary course of carrying on their business."

As against the grantor, a mortgage of income must be taken to include after-acquired rolling stock. Louisville Trust Co. v. Cincinnati Inclined Plane R. Co. 91 Fed. 699.

[31] Parker v. New Orleans &c. R. Co. 33 Fed. 693; Coe v. Del., L. &c. R. Co. 4 Am. & Eng. R. Cas. 513.

[32] Seymour v. Canandaigua & N. F. R. R. Co. 25 Barb. (N. Y.) 284

[33] Meyer v. Johnston, 53 Ala. 237, 331; 64 Ala. 603.

[34] Seymour v. Canandaigua &c. R. Co. 25 Barb. (N. Y.) 284.

encourage the construction of necessary public works.[35] The lien of a mortgage previously executed is not impaired by any deviation in the route, so long as this is kept within the general plan and direction authorized by the charter of the road.[36] If a company, after partially building a portion of its road, abandons it for another route on which the road is actually built, the lien of the mortgage will cover the latter location, but not the former, over which the company had only a right of way; for that, in consequence of the abandonment, reverts to the owners of the soil.[37]

A mortgage by a railway company of its road constructed and to be constructed, and of all lands owned by it, or which it might afterwards acquire for the purposes of its road, takes effect as a specific lien upon such lands as soon as they are acquired. The description of the land is made intelligible and definite by reference to the charter of the road, which defines the land the company may take.[38] It is immaterial whether the road has been definitely located at the time of the mortgage; when it is located, the lands acquired within the line of its location and for the use of the road so located will be embraced in the mortgage.

§ 102. **The operation of a mortgage in respect to future-acquired property may of course be limited** to such property as might be purchased with the money obtained from the mortgage loan. Such was claimed to be the effect of certain mortgages of the New Albany and Salem Railroad Company, incorporated under the laws of Indiana. The mortgage covered all the present and future to be acquired property pertaining to the road. The Supreme Court of the United States[39] decided that the terms of the mortgage were broad enough to cover all property pertaining to the road, not only that existing at the date of the mortgage, but also such as was afterwards substituted for property then existing, or was subsequently added by the company, and was in existence at the time of the foreclosure. The reference made in the description to the property which

[35] Elwell v. Grand St. &c. R. Co. 67 Barb. (N. Y.) 83.

[36] Meyer v. Johnston, 53 Ala. 237, 331; 64 Ala. 603.

[37] Meyer v. Johnston, 53 Ala. 237, 331; 64 Ala. 603.

[38] Seymour v. Canandaigua &c. R. Co. 25 Barb. (N. Y.) 284.

[39] Shaw v. Bill, 95 U. S. 10; Calhoun v. Memphis &c. R. Co. 2 Flip. (U. S.) 442.

might afterwards be purchased with the bonds issued was declared not to operate as a limitation of the lien of the mortgage to such after-acquired property, but only to remove any doubt that might otherwise possibly arise whether the property thus purchased would also go to increase the security offered. It was not deemed of any moment whether the rolling stock and machinery in use by the company at the date of the decree were acquired with the proceeds of the bonds or with the subsequent earnings of the company.

§ 103. After-acquired land, not within the terms of a mortgage, is not covered by it. A mortgage of a road and its appurtenances, the land on which it is constructed, and which it may acquire for stations, engine houses, shops, and other structures, or upon which embankments, drains, and fences might be built, does not create any lien upon a tract of woodland afterwards acquired by the company, situate seven miles from the road, although such land was purchased and used by the company for the purpose of supplying the road with timber and wood. The mortgage in terms relates to land along the line of the road, in immediate connection with it, and necessary for the operation of it; and it contains no apt and proper language to embrace land remote from the road, and which cannot be used for any of the specific purposes mentioned.[40]

A mortgage by a railway company of its "road, . . . whether made or to be made, acquired or to be acquired, and all its property, real and personal, whether now owned or hereafter to be acquired, used, or appropriated for the operating or maintaining the said road," is by its terms restricted to property so used or appropriated.[41] Lands acquired by the company, and not thus used or employed for the purposes of the road, would not come within the description of the mortgage.[42] But land purchased for railroad purposes would

[40] Dinsmore v. Racine &c. R. Co. 12 Wis. 649.

A corporate mortgage of after-acquired property was held not to cover a water-ditch constructed by a new company, although the directors of the old and new company were identical. Farm. Ins. Co. v. Alta L. & W. Co. 28 Colo. 408; 64 Pac. 198.

[41] Walsh v. Barton, 24 Ohio St. 28. See Ruhlender v. Chesapeake &c. R. Co. 91 Fed. 5, holding certain lots were acquired for railway purposes.

[42] Seymour v. Canandaigua &c. R. Co. 25 Barb. (N. Y.) 284; Nat. Bank of Commerce v. Lock, 17 Wash. 528; 50 Pac. 478; 61 A. S. R.

be subject to the lien of the mortgage, though it is subsequently found unsuitable for such purposes and sold. When once the lien of the mortgages attaches, subsequent contingencies regarding the use of the land do not affect the mortgage.[43]

§ 103a. **The term "depot" in a mortgage** is not necessarily limited to a place provided for the convenience of passengers. It applies also to buildings used for the receipt and storage of freight. Such a building, whether existing at the time of the mortgage, or constructed afterwards upon the property of the company covered by the mortgage, may pass under the mortgage as one of its depots, but will not pass as an appurtenance to the property already existing.[44]

§ 104. **After-acquired personalty not within the terms of the mortgage.**—A mortgage conveying a "railroad, with its superstructure, track, and all other appurtenances, made or to be made," and also the "railroad furniture, including engines, tenders, cars of every description, tools, materials, machinery, and every other kind of personal property which shall be used for operating said railroad," does not purport to grant property thereafter to be acquired by the company, except so far as it becomes appurtenant to the road, or is used in it. Chairs intended for fastening down the rails afterwards acquired, which were never used in its construction, but were lying upon the ground in heaps, are not appurtenant to the road or used in operating it, within the terms of the mortgage, and consequently are not covered by it. There is no language in the instruments which purports to convey materials to be thereafter acquired for the construction or repair of the road.[45]

Upon a second trial of this case additional evidence was introduced to show that the intention of the parties was to grant everything that the company then owned or might afterwards acquire: and it was claimed that the intention of the parties should be ar-

[43] Hawkins v. Mercantile Trust Co. 96 Ga. 580; 23 S. E. 498.

[44] Humphreys v. McKissock, 140 U. S. 304; 11 S. Ct. 779.

[45] Farmers' &c. Co. v. Commercial Bank, 11 Wis. 207; affirmed in Dinsmore v. Racine &c. R. Co., 12 Wis. 649; Farmers' &c. Co. v. Cary, 13 Wis. 110; Farmers' &c. Co. v. Commercial Bank, 15 Wis. 424; 82 Am. Dec. 689.

rived at, as well from consideration of their situation and the general nature and object of railroad mortgages as from the words in the instrument. "But it must be borne in mind," say the court,[46] "that it is not the business of construction to look outside of the instrument to get at the intention of the parties, and then carry out that intention, whether the instrument contains language sufficient to express it or not; but the sole duty of construction is to find out what was meant by the language of the instrument. And this language must be sufficient, when looked at in the light of such facts as the court is entitled to consider, to sustain whatever effect is given to the instrument. And we can see nothing in the additional evidence now before us which we think ought to change the effect before given to the mortgages under which the appellant claims."

Upon this principle, a mortgage of the Vermont Central Railroad Company of its road and appurtenances, together with "all other personal property belonging to said company, as the same now is in use by said company, or as the same may be hereafter changed or renewed by said company," was held not to embrace certain machinery for "burnetizing" ties and timber so as to render them more durable, which machinery was not in existence at the time of the mortgage, and took the place of nothing that was therein specified. Neither is such machinery any part of the necessary furniture or equipment of the road: and therefore, although such a mortgage might cover new engines or cars, or the like, procured to replace such as had been worn out, it could not be extended so as to embrace property not used upon the road, and in no sense a part of it.[47]

§ 105. A mortgage may be made of a land grant to a railroad company before the grant has been located by the filing of a map

[46] Farmers' &c. Co. v. Commercial Bank, 15 Wis. 424, 438; 82 Am. Dec. 689. Extrinsic evidence is admissible to show whether land was acquired for railroad purposes so as to bring it within the description of a mortgage. The parts of a large tract not used for railroad purposes would not be included in the mortgage, though it was purchased entire and used in part for the right of way. Aldridge v. Pardee, 24 Tex. Civ. App. 254; 60 S. W. 789.

[47] Brainerd v. Peck, 34 Vt. 496. Upon the same principle a hotel would not pass under a railway mortgage covering after-acquired property. Guaranty Trust Co. v. Atlantic &c. R. Co. 132 Fed. 68.

in the proper office, or even before the grant has been made. Whether the company has earned the grant by performing the conditions imposed in the grant is immaterial, unless the government itself seeks a forfeiture of the grant for that reason.[48]

But the authority of a railroad company to bind its future acquisitions by mortgage is held to be limited to such acquisitions as it then has the power by charter or by general law to make. Upon this ground it was held that a mortgage by the Alabama and Tennessee River Railroad Company did not cover a grant of lands subsequently made by the United States, which the company was by special act empowered to accept, because it had no power to accept such a grant when the mortgage was given, and the acquisition of such a land grant was not then contemplated. Although the mortgage in terms covered the road and the corporate franchises, together with "all other property now owned and which may be hereafter owned by the railroad company," its operation was restricted to such property as the company then had power to receive and hold.[49]

§ 106. **In a mortgage of a land grant not yet earned,** an element of uncertainty may be introduced by including only a portion of the grant, without particularly describing that portion. Thus where a railroad company, which, upon completing its road according to certain conditions, would become entitled to receive sixteen sections of land of six hundred and forty acres each for each mile of road, included in a mortgage only twelve sections per mile, amounting to thirteen hundred and twenty sections, reserving four sections per mile, or four hundred and forty sections in all, to be used in constructing their road, and afterwards transferred four hundred and seventy-two sections to a contractor, who received the certificates in good faith without any knowledge of their being mortgaged or pledged in any manner, it was held that he acquired a good title to these sections, free from the incumbrance of the mortgage.[50] For

[48] Parker v. New Orleans &c. R. Co. 33 Fed. 693.

[49] Meyer v. Johnston, 53 Ala. 237, 331; 64 Ala. 603.

[50] Campbell v. Texas & N. O. R. Co. 2 Woods (U. S.) 263, 271. "This is the doctrine of equity," said Mr. Justice Bradley, delivering the opinion of the United States Circuit Court. "To this the court holds the company, and as against it and its assigns, having notice of the contract, they treat the certificates as if they had been in exist-

the mortgage bondholders it was contended that the land grant, to the extent of thirteen hundred and twenty sections, became a lien upon this number of sections as soon as the company received them from the state; and that if there was any difficulty in finding the balance, the contractor must meet it; and therefore they demanded that the contractor should surrender all the certificates held by him, or, at all events, that the land should be subject to sale under the decree, until the number of thirteen hundred and twenty sections had been made good. Their claim, however, was not by absolute grant or assignment, but through the effect of the trust deed operating by way of estoppel; for at the time the deed was executed the company had not received the grant, nor earned it by the building of the road. The deed amounted to a covenant on the part of the company that the certificates for the land should be included in the mortgage when they should come into existence.

This decision, upon the facts stated, cannot be questioned. It does not appear from anything stated in the report of the case whether the trust deed was duly recorded or not. If it was recorded, it is difficult to see how the contractor could have received the certificates without notice of the prior right of the mortgagee to re-

ence, and had been embraced in the trust deeds when they were executed. But the courts will not override other equities in coming to this result. If parties purchased the certificates in good faith, and without notice of any such estoppel, it would be doing injustice to them to deprive them of the certificates so purchased. In the case before us there was a margin of four sections per mile, over and above the amount or number of sections pledged to the bondholders, which the company itself had a perfect right to dispose of. It would be naturally supposed by parties dealing with the company, even if they knew of the existence of the trust deeds, that so long as the company kept within the line of this margin in issuing additional certificates, no interference was made with those to which the trustees under the trust deeds were entitled. If a man sells me fifty bushels from a lot of one hundred bushels of corn, and a third person afterwards, with knowledge of the sale to me, purchase the remainder, and removes his part of the lot, leaving my quantity undisturbed, how can he be liable to me, even though the seller should afterwards fraudulently dispose of my part to other parties?" The learned judge was therefore brought to the conclusion that the contractor was entitled to be protected in the possession and enjoyment of the certificates transferred to him.

ceive certificates for twelve sections of land per mile of road, and, consequently, why he had not a prior lien upon the land to the amount of thirteen hundred and twenty sections.

§ 106a. A land grant made subsequent to a mortgage covering after-acquired property is not included under it. The terms of the mortgage cover land necessary to the operation of the road and appurtenant to it. No argument is needed to show that a land grant is not necessary to the operation of a railroad; it may be a necessary aid in the construction of a road, but it is not necessary in its operation. The word "appurtenant," as ordinarily defined, is that which belongs to or is connected with something else to which it is subordinate or less worthy, and with which it passes as an incident, such as an easement or servitude to land. Property not connected with what is ordinarily termed the plant, or not forming a part of the organic structure of the road, is never treated as appurtenant to it.[51]

§ 107. A mortgage by a railroad company embracing all property which it may subsequently acquire includes a lease which it afterwards takes of another railroad. Upon the subsequent bankruptcy of the corporation, its assignees in bankruptcy cannot maintain a title to the leased road as against the mortgage trustees.[52]

Lands which a railroad company has contracted for after a mortgage of all its property, and has taken possession of and used for depot grounds, paying a portion of the purchase money, are subject to the mortgage; and the mortgagee, or the purchaser under the mortgage, may compel the execution of a conveyance upon the payment of the balance of the purchase money.[53]

§ 108. But a mortgage of after-acquired property does not include a lease made by the mortgagor to another company of the

[51] New Orleans Pac. R. Co. v. Parker, 143 U. S. 42; 12 Sup. Ct. 406.

[52] Barnard v. Norwich &c. R. Co. 4 Cliff (U. S.), 351; 14 N. Bank R. 469; 3 Cent. L. J. 608; Hamlin v. E. & N. A. R. Co. 72 Me. 83; Columbia F. & T. Co. v. Kentucky Union R. Co. 60 Fed. 794.

[53] Farmers' &c. Co. v. Fisher, 17 Wis. 114; Hamlin v. E. & N. A. R. Co. 72 Me. 83; Guaranty Trust Co. v. Atlantic &c. R. Co. 138 Fed. 517; S. C. 132 Fed. 68; Columbia &c. Co. v. Kentucky Union R. Co. 60 Fed. 794.

mortaged road; for the lease is not a new estate acquired by the mortgagor, but rather an estate granted by the mortgagor. No case has gone to the extent of holding that personal contracts or covenants entered into with the mortgagor come within the terms of after-acquired property.[54]

§ 108a. **An equitable estate and right of redemption in the mortgagor corporation** is at once covered by a previous mortgage including after-acquired property. It is well settled that a mortgage with an "after-acquired property" clause in it, embraces and creates a charge upon all property subsequently acquired by the corporation mortgagor which comes within the description in the mortgage; and this is so, not only as to property to which the mortgagor acquires the legal title, but also as to that to which it acquires only an equitable title.[55]

§ 108b. **An extension of a franchise to pipe gas through the streets of a city** has been held to be included under a mortgage of after-acquired property. "To hold otherwise," said the court, "would be to fly in the face of the explicit and express terms of the mortgage, viz., that it covered all improvements and additions of every name and nature." The charter of the old company had but six or seven years to run. Naturally the new company would be seeking, and might at any time obtain, a new franchise. The new company did, in fact, without the knowledge or consent of the old company, wipe out the rights under the old franchise and accept a new ordinance for thirty years. The new company had not the franchise which it purchased and mortgaged to be reconveyed on a foreclosure sale. Therefore the mortgage covers additions of every kind, and also the new franchise.[56]

§ 109. **The enumeration of some articles excludes others.**[57] The

[54] Moran v. Pittsburgh, C. &c. R. Co. 32 Fed. 878; St. Paul &c. R. Co. v. United States, 112 U. S. 733; 5 Sup. Ct. 366.

[55] Brady v. Johnson, 75 Md. 445; 26 Atl. 49; 20 L. R. A. 737-n. Central Trust Co. v. Kneeland, 138 U. S. 414, 419; 11 Sup. Ct. 357; Toledo D. & B. R. Co. v. Hamilton, 134 U. S. 296; 10 Sup. Ct. 546.

[56] Lewis v. Wiedenfeld, 114 Mich. 581; 72 N. W. 604.

[57] Hare v. Horton, 5 Barn. & Ad. 715; Raymond v. Clark, 46 Conn. 129; Buck v. Seymour, 46 Conn. 15[illegible].

Vermont Central Railroad Company having made a mortgage which by its terms covered such personal property as might afterwards be changed or removed by the company, some years afterwards made a conveyance apparently in confirmation of this provision of the mortgage, reciting that the personal property existing at the date of it had become diminished and impaired by use, and other personal property acquired, which had gone into the possession of the trustees, and therefore this deed was executed to carry the mortgage into effect. The deed, however, was "of all the articles of personal property acquired by the company since the date of the mortgage, consisting, among other things, of the following, to wit:" and then enumerated by name several engines, and by number several different kinds of cars. It was held that these general words should be construed as referring only to articles of the same nature and kind as those specifically named, and therefore did not embrace machinery for "burnetizing" ties and timber.[58]

A mortgage of after-acquired property, the different kinds of which are described in detail, does not, by the use of the general word "property," embrace certain municipal bonds issued to the company and held by it to aid in building the road.[59]

§ 110. Capital stock of another company. A mortgage given upon the real and personal property of a railroad corporation then held or acquired, or thereafter to be held or acquired, covers the capital stock of another railroad company, subsequently purchased by the mortgagors for the purpose of effecting a consolidation of the roads.[60] It is not necessary to the validity of such a mortgage that it should have been filed in accordance with the provisions of the act concerning chattel mortgages. The capital stock of a corporation is not goods or chattels within the meaning of the statute, which has reference only to pledges of personal property of a kind which is capable of visible possession.[61]

Furthermore, a certificate of stock in an elevator corporation can-

[58] Brainerd v. Peck, 34 Vt. 496.

[59] Smith v. McCullough, 104 U. S. 25.

[60] Williamson v. N. J. Southern R. Co. 26 N. J. Eq. 398; Guaranty Trust Co. v. Atlantic &c. R. Co. 138 Fed. 517; 132 Fed. 68.

[61] Williamson v. N. J. Southern R. Co. 26 N. J. Eq. 398.

not be an appurtenance to a railroad. If stock in such a company could be considered an appurtenance to a railroad, by the same rule stock in a bank, or in any other corporation with which the railroad does business, might be so considered.[62]

§ 111. Iron rails not laid. A mortgage of "all rolling stock, equipments, and materials whatsoever," which may be acquired by the mortgagor, or furnished for the use of its road, embraces iron rails purchased by the company for its use, although still in the hands of its agents at a distant port. The St. Paul and Pacific Railroad Company having made such a mortgage after having purchased a large amount of iron, by a resolution of its board of directors authorized one of the mortgage trustees to pledge, hypothecate, sell, or dispose of the iron rails of the company, then in New York or elsewhere, or afterward to arrive, for such sums and on such terms as were in his judgment best for the interest of the company, for the purpose of raising money necessary to meet past and future estimates for construction account of the extension of the roads, and for duties, freights, and advances on the same account; and the trustee accordingly disposed of the railway iron principally to the firms of Jay Cooke & Co., and Jay Cooke, McCulloch & Co., of both of which firms this trustee was a member. He was also the acting man of the mortgage trustees, and the construction agent of the company. An action was brought against the company, the mortgage trustees, and others, to restrain this fraudulent diversion of the iron, and it was held that the action could be maintained, and that an injunction restraining the completion of the transfer of the property was properly granted.[63] The iron rails became a part of the security in equity against persons buying them with notice of the facts, or without paying value for them. To that extent the bondholders had an equitable right that they should be used only for the purposes for which they had been bought, and that was, to construct the railroad track with them. The firms of which the trustee was a member are chargeable with knowledge of the mortgage,

[62] Humphreys v. McKissock, 140 U. S. 304; 11 Sup. Ct. 779.

[63] Weetjen v. St. Paul &c. R. Co. 4 Hun (N. Y.) 529. The same has been held of fish plates and bolts. Farmers' &c. Co. v. San Diego &c. Co. 49 Fed. 188.

and the equitable lien of it upon this property, and therefore they could acquire no title as against the bondholders. A portion of the iron was transferred by Jay Cooke, McCulloch & Co. to the secretary of the navy of the United States, in part to secure a debt of the firm and in part to secure an advance made at the time. Accordingly, it was held that the transfer was invalid so far as it secured a prior indebtedness, because the secretary relinquished nothing for the transfer, and took no better title than the firm themselves had; but so far as the transfer secured an advance made at the time, the transaction was valid, being without notice of the equity of the bondholders and for an actual consideration paid.

§ 112. **Fuel.** The Androscoggin Railroad Company having been authorized to extend its road, and to make a mortgage of the property then owned by both the new and old portions of the road, and "all the property of said extension subsequently to be acquired," and having executed the mortgage accordingly, afterwards purchased with the earnings of the whole road wood for the use of the whole road. It was held that such wood was not property of the extension afterwards acquired, within the terms of the mortgage, and was therefore subject to attachment at the suit of a creditor of the company.[64]

§ 113. **Office furniture,** suitable in kind and of a necessary amount, provided for the use of the employees of the company in the performance of their daily duties, as well as for the use of the directors of the company to transact their business, is embraced in a mortgage of a road, its franchises and property then owned or thereafter to be acquired.[65] Such property of a railroad company is attached to or incident to the road itself. The mortgagee may, upon default, take possession of it; or if a judgment creditor attempts to levy an execution upon it, the mortgagee may have the proceedings enjoined, especially if it appears that the other mortgaged property would be insufficient to pay in full the mortgage debt.[66]

[64] Bath v. Miller, 53 Me. 308. See § 79; and also Hunt v. Bullock, 23 Ill. 320.

[65] Wood v. Whelen, 93 Ill. 153.

[66] Ludlow v. Hurd, 1 Dis. (Ohio) 552; Raymond v. Clark, 46 Conn. 129. See § 77. Contra, Hunt v. Bullock, 23 Ill. 320.

III. *Mortgages attach to After-acquired Property subject to Liens upon it when acquired.*

§ 114. A mortgage of after-acquired property can only attach to such property in the condition in which it comes into the mortgagor's hands.[67] If it is already subject to mortgages or other liens, the general mortgage does not displace them, although they may be junior in point of time. They only attach to such interest as the mortgagor acquires. Therefore a mechanic's lien for work done and materials furnished in building for a railroad company docks, wharves, and piers upon a branch road, acquired after the making of the mortgage, takes precedence of the mortgage. It is immaterial in such case that the property was acquired, not by grant, but by obtaining a controlling interest in the capital stock of another road which owned the property.[68] When in this case the decree of the chancellor was signed, which established the lien of the mortgage upon the branch road, a mechanic's lien had been acquired on the premises, which related back to the commencement of the building, and was entitled to priority over all conveyances, mortages, or incumbrances subsequent thereto. This lien was not displaced by the chancellor's decree, which, in the absence of fraud, could be effective only to bring under the mortgage the lands of the branch company, subject to such liens as were lawfully acquired while the legal estate was in that company.[69]

[67] Dunham v. Cincinnati &c. R. Co. 1 Wall (U. S.) 254; Galveston R. Co. v. Cowdrey, 11 Wall. (U. S.) 459; United States v. N. O. R. 12 Wall. (U. S.) 362; Willink v. Morris Canal &c. Co. 4 N. J. Eq. 377; Boston Safe &c. Co. v. Bankers' &c. Tel. Co. 36 Fed. 288; Western Union Tel. Co. v. Burlington &c. R. Co. 3 McCrary (U. S.) 130; Fosdick v. Schall, 99 U. S. 235; Myer v. Car Co. 102 U. S. 1; Branch v. Jesup, 106 U. S. 468; 1 S. Ct. 495; Central Trust Co. v. Kneeland, 138 U. S. 414, 419; 11 Sup. Ct. 357; Brady v. Johnson, 75 Md. 445; 26 Atl. 49; 20 L. R. A. 737; Reed v. Ginsburg, 64 Ohio St. 11; 59 N. E. 738. As to statutory lien for construction expenses, see Central Trust Co. v. Louisville &c. R. Co. 70 Fed. 282.

[68] Williamson v. New Jersey &c. R. Co. 28 N. J. Eq. 277, 298; 29 N. J. Eq. 311.

[69] S. C. in Court of Errors and Appeals, March T. 1878, affirming the chancellor's decree upon this point. 29 N. J. Eq. 311.

Where rolling stock was paid for by bonds secured by mortgage of after-acquired property, the bonds

§ 115. **This rule does not apply as to articles which become a part of the permanent structure of a railroad,** such as rails and bridges.[70] Such articles, when they become affixed to and a part of a railroad covered by a prior mortgage, will be subject to the lien of the mortgage, as against any contract between the furnisher of the property and the railroad company that the articles should remain the property of the furnisher until paid for. The rule is applicable to such property as rolling stock, and to loose property susceptible of separate ownership and of separate liens, and to real estate not used for railroad purposes.[71]

Fixtures and improvements attached to the property and intended to become or to be used as part and parcel of it, though attached after the execution of the mortgage, are covered by it in law as if the improvements had been a part of the property originally mortgaged.[72]

§ 116. **It is competent, however, for the parties in interest to determine by agreement the legal character of property annexed,** as against an existing mortgage. Thus, also, telegraph wires may be strung and connected with an existing system of telegraph lines, and by agreement of the parties in interest may remain personal property, as against a mortgage of the general system.[73]

constituted a prior lien over a chattel mortgage of future property given to third parties by the agent making the purchase. Flanagan Bank v. Graham, 42 Or. 403.

Lien of future mortgage takes preference over landlord's statutory lien. Manhattan Trust Co. v. Sioux City & N. R. Co. 68 Fed. 72.

[70] Porter v. Pittsburgh Bessemer Steel Co. 120 U. S. 649; 7 Sup. Ct. 1206; 30 Am. & Eng. R. Cas. 495; Toledo &c. R. Co. v. Hamilton, 134 U. S. 296; 10 Sup. Ct. 546.

[71] Western Union Tel Co. v. Burlington & W. R. Co. 3 McCrary (U. S.) 130; 11 Fed. 1; Frank v. Denver & R. G. R. Co. 23 Fed. 123; Central Trust Co. v. Ohio C. R. Co. 36 Fed. 520.

[72] Wood v. Whelen, 93 Ill. 153; United States v. N. O. R. Co. 12 Wall. (U. S.) 362; Boston Safe &c. Co. v. Bankers' &c. Tel. Co. 36 Fed. 288.

Liens on improvements, etc., can by statute be given priority over a mortgage of future-acquired property. And the mortgagor is in no position to object to the ruling of a court in regard to the rights of rival claimants. St. Louis &c. R. Co. v. Kerr, 153 Ill. 182; 38 N. E. 638.

[73] Boston Safe &c. Co. v. Bankers'

§ 117. **Such a mortgage is subject to a vendor's lien for unpaid purchase money,** and as to such land the mortgagee is not a purchaser for value. The vendor's lien attaches not only against the vendee and his heirs, but also against his privies in estate, and against subsequent purchasers who have notice of it, either actual or constructive. It exists also against those who take a conveyance without advancing any new consideration. Where the mortgage does not describe the land to be subsequently acquired, as is the case usually, the mortgagee cannot be regarded as a purchaser for a present consideration in good faith without notice.[74]

§ 118. **Such mortgage is subject to the rights of owners of land taken for right of way,** compensation for which has not been made. Until the damages for the taking of such property have been paid or secured, the landowner has an estate in the property rather than a lien, and the rights of a mortgagee are subject to the paramount constitutional right of the owner of the legal estate.[75]

But when a railroad company holds property under a conditional sale, as, for instance, when railroad iron has been annexed under an agreement that it shall be laid upon a designated part of the track, and that upon payment it shall become the property of the company, but that the title should not pass until such payment, a *subsequent* mortgagee of the road with notice of the agreement acquires no interest in it.[76] There is in such case no difficulty in tracing and identifying the iron. It is unlike a case where bricks, or nails, or other materials are used in the construction of a house, and are so incorporated with the building that they cannot be separated and

&c. Tel Co. 36 Fed. 288; Western Union Tel Co. v. Burlington &c. R. Co. 3 McCrary (U. S.) 130.

[74] Loomis v. Davenport &c. R. Co. 17 Fed. 301; Central Trust Co. v. Louisville &c. R. Co. 81 Fed. 772. See, to the contrary, Pierce v. Milwaukee &c. R. Co. 24 Wis. 551; 1 Am. Rep. 203, where, however, the contest was between the vendor and the purchaser at the sale under a decree of foreclosure, who was not charged with notice.

The general rule applies when a third person furnishes money to buy the property and takes a mortgage in return. Harris v. Youngstown Bridge Co. 90 Fed. 322.

[75] Buffalo &c. R. Co. v. Harvey, 107 Pa. St. 319; 26 Am. & Eng. R. Cas. 642; Central Trust Co. v. Louisville &c. R. Co. 81 Fed. 771.

[76] Haven v. Emery, 36 N. H. 66.

traced. It is rather analogous to the case of a house or a fence set on land of another, with his assent, and under an agreement that the house or fence should remain the personal property of the original owner. The agreement of the parties would supersede the general rule of law, and prevent the house or fence becoming annexed in law to the land. The mortgagee with notice stands in the same position as the company itself. Notice to the trustees under the mortgage is notice to the bondholders. It would be impracticable to affect the bondholders with actual notice in any way except through the trustees, through whom the bondholders claim.

A verbal agreement of the mortgagor, that after-acquired property shall remain the property of the vendor until it is paid for, does not constitute a lien within the rule that a mortgagee takes after-acquired property *cum onere;* at any rate, such is the law when the property is personal, and a statute makes an agreement that the vendor shall retain the title invalid against creditors without notice unless the instrument be in writing and recorded.[77]

§ 119. The mortgage does not cover property afterwards acquired through fraud. Mortgagees of a railway who have taken possession of the road under their mortgage cannot, however, retain possession of rolling stock which the company has acquired by fraud. The Lehigh Car Manufacturing Company contracted to deliver to the New Jersey Southern Railroad Company one hundred box cars at a stipulated price, payable in the notes of the company secured by its first mortgage bonds. A part of the cars was delivered to the company, which gave its notes and certain bonds called consolidated first mortgage bonds as security. The manufacturers, having been informed some time afterwards that the bonds were not first mortgage bonds, inquired of the secretary of the company about them, and was assured that they were such bonds. Some two or three months afterwards the manufacturers, having discovered that the bonds received were worthless, demanded a return of the cars, which was refused. The company was shortly afterwards declared insolvent, and possession of its property was delivered to the trustees of the first mortgage bondholders. The Trustees insisted that the

[77] Taylor v. Burlington &c. R. Co. 11 West Jur. (Ia.) 337.

car company could not be permitted to rescind the contract of sale and retake the cars, because they did not elect to do so within a reasonable time. The car company, on the other hand, claimed that they were defrauded in the transaction, and that they took advantage of the fraud in due season after the discovery of it. It appeared that the consolidated bonds were issued under a scheme started by Jay Gould, then the president of the road, for the consolidation of several roads, and the retiring of the existing bonds of the road by issuing the new consolidated bonds. The consolidation of the roads never took place, and the bonds issued to the car company were worthless. The chancellor held that, although the property passed by the sale, which was not void, but only voidable at the election of the vendor, the latter might rescind the contract of sale at any time after the discovery of the fraud, so long as no innocent third party had acquired an interest in the property, and the position of the railroad company was no worse by reason of the delay. The sale was regarded as conditional, the condition being that the security provided for in the contract should be given simultaneously with the delivery of the property. The car company did not lose its property in the cars by delivering them to the railroad company, because, the cars being built according to specifications, the vendee had the right, as incident to the contract, to require a delivery of them for the purpose of inspection and examination.[78]

Moreover, the car company, having been induced to part with the cars by fraudulent means, could, within a reasonable time, disaffirm the sale and reclaim the property. Although delivery had been made, no title would pass until with knowledge of the fraud it elected to ratify and confirm the sale, or third persons acting upon the supposition of the ownership by the fraudulent vendee had, in good faith and for a valuable consideration, acquired rights therein. But the mortgagee in this case occupied no better position, either at law or in equity, than the railroad company. When he took possession of the road under the mortgage, he took possession of the cars as part of the equipment; but he paid no consideration for them, and parted with nothing on the faith of the supposed ownership of the property by the mortgagor. Although a mortgage of property after-

[78] Williamson v. New Jersey &c. R. Co. 28 N. J. Eq. 277.

wards to be acquired attaches to the property as soon as it comes into the possession of the mortgagor, this is only in accordance with the principle of equity, that what ought to be done is considered as done. Unless the mortgagee has an equitable right to hold such property, such as would be the ground of a decree of specific performance, a court of equity will not aid him in enforcing the contract.

Upon appeal from the decree of the chancellor, the Court of Errors and Appeals held that the relief granted by that decree was too circumscribed, and that the decree should be modified, and a decree made in favor of the car company for the value of the cars in the complainant's possession at the time of demand made on him at what they were then worth, with interest on such valuation, to be ascertained by a reference to a master.[79]

§ 119a. **Second mortgage preferred over fraudulent first mortgage.**—Where promoters by false representations induce an owner of land to convey it to the corporation and to accept in part payment second mortgage bonds, so as to let in as a first lien certain first mortgage bonds which are held by the promoters, the lien of such first mortgage cannot obtain priority over the second mortgage for the unpaid purchase money. The first mortgage bondholders are not *bona fide* purchasers of the bonds without notice, but are the real purchasers of the property, and owe the balance of the purchase money, and since they induced the vendor to waive his lien by fraud, they cannot claim a preference. Equity will never allow the mere form in which a transaction is clothed or disguised by the parties who have projected it for their own gain, to control or defeat the legal or equitable rights of others.[80]

§ 120. **Junior mortgagees of railroad property who by express terms take subject to a prior mortgage of the road, constructed or to be constructed,** all property then owned by the corporation or afterwards to be acquired for the use of the road, cannot claim such after-acquired property as against the prior mortgagees. The junior

[79] Williamson v. New Jersey &c. R. Co. 29 N. J. Eq. 311, 321.

[80] Hooper v. Central Trust Co. 81 Md. 559; 32 Atl. 505; 29 L. R. A. 262.

mortgagees are not in such case *bona fide* purchasers for value without notice.[81] And in like manner the holders of a chattel mortgage upon the rolling stock of a railroad, who had previously as agents of the railroad company actively participated in negotiating a prior mortgage of the road and all its after-acquired property, cannot claim to avoid such prior mortgage in respect to after-acquired rolling stock, or question its validity because it was not filed as a chattel mortgage.[82]

A town voted bonds in aid of a railroad on condition that a certain amount of *first* mortgage bonds of the railroad should be deposited with the town treasurer. The railroad had in fact made a prior mortgage to secure an indemnity bond for advances made by the state, but it was held that the vote clearly referred to the bonds secured by the second mortgage, as there was no issue of ordinary bonds under the first mortgage.[83]

[81] Stevens v. Watson, 4 Abb. App. Dec. (N. Y.) 302.

[82] Benjamin v. E. J. & C. R. Co. 54 N. Y. 675; 49 Barb. (U. S.) 441.

[83] Commonwealth v. Williamstown 156 Mass. 70; 30 N. E. 472.

CHAPTER V.

LEGAL NATURE OF ROLLING STOCK OF RAILROADS.

I. After-acquired rolling stock subject to mortgage, §§ 122–127.

II. Mortgages of after-acquired rolling stock as affected by conditional sales, §§ 128–135.

III. Rolling stock regarded as fixtures, §§ 136–144.

IV. Rolling stock regarded as personal property, §§ 145–150.

V. Constitutional and statutory provisions regarding rolling stock, §§ 151–168.

§ 121. **Introductory.** When rolling stock is mortgaged in connection with the real property of a railroad company, the effect of the mortgage may be considered as between the parties themselves, or as between the mortgagees and subsequent purchasers or judgment creditors. Between the parties themselves, no question as to the proper registration of the mortgage can arise; and, generally, the only question between them respecting such property is whether the mortgage covers after-acquired property of this kind.[1] The same question may arise between the mortgagees and subsequent purchasers or incumbrancers. Quite different principles, however, are applicable to the determination of this inquiry from those that apply to the contentions of the same parties whether such property is a fixture—and, therefore, a part of the realty itself—or is personalty. Upon this part of the subject there is great confusion and contradiction of authority. In many states there are now statutory enactments which attempt to dispose of the vexed questions; but these enactments are as diverse as were the decisions of the courts. It

[1] Hamlin v. Jerrard, 72 Me. 62.

is of little consequence, however, whether the statutes fix the *status* of such property as realty or personalty, so long as they afford a fixed rule for the guidance of the parties.

Discriminating, therefore, between the different aspects of the subject presented by these legal questions, the first matter to be considered is,—

I. *After-acquired Rolling Stock subject to Mortgage.*

§ 122. A mortgage of a railroad afterwards to be built, and of the rolling stock and other property appurtenant to such road, attaches to the road and the rolling stock as they are built and acquired. Such a mortgage is a lien superior to that of a subsequent mortgage, made after the road has been completed and equipped; and in like manner superior to a judgment lien which has afterwards attached to such property.[2] Although the mortgage may have been "given before a shovel had been put into the ground towards constructing the railroad, yet, if it assumed to convey and mortgage the railroad which the company was authorized by law to build, together with its superstructure, appurtenances, fixtures, and rolling stock, these several items of property, as they came into existence, would become instantly attached to and covered by the deed, and would have fed the estoppel created thereby: No other rational or equitable rule can be adopted for such cases. To hold otherwise would render it necessary for a railroad company to borrow money in small parcels, as sections of the road were completed, and trust deeds could safely be given thereon. The practice of the country and its necessities are in coincidence with the rule."[3]

One of the earliest cases involving a judicial construction of a mortgage of the rolling stock of a railroad company was decided by

[2] Pennock v. Coe, 23 How. (U. S.) 117; Galveston R. v. Cowdrey, 11 Wall. (U. S.) 459, 481; Dunham v. Cincinnati &c. R. Co. 1 Wall. (U. S.) 254, 266; Meyer v. Johnston, 53 Ala. 237, 324; 64 Ala. 603; Scott v. Clinton &c. R. Co. 6 Biss. (U. S.) 529, 535; Michigan, &c. R. Co. v. Chicago &c. R. Co. 1 Bradw. (Ill.) 399; Nichols v. Mase, 94 N. Y. 160; Manchester Locomotive Works v. Truesdale, 44 Minn. 115; 46 N. W. 301; 9 L. R. A. 140n.

[3] Galveston R. Co. v. Cowdrey, 11 Wall. (U. S.) 459, 481; per Bradley, J.

the Circuit Court of the United States in 1857, and two years afterwards by the Supreme Court.[4] In this case it appeared that a railroad company executed a mortgage of all its present and subsequently acquired property, including engines, tenders, cars, and all other personal property. The railroad was in course of construction, and only a small portion of it was finished at the time of the mortgage. This contained a covenant that the money borrowed should be applied to the construction and equipment of the road. The rolling stock was afterwards levied upon by holders of subsequent mortgage bonds. Whereupon the trustees under the first mortgage filed a bill to restrain a sale under the execution. The Circuit Court rendered a decree perpetually enjoining the sale, and this decree was affirmed by the Supreme Court.

§ 123. It is not essential that the rolling stock should be especially mentioned in the mortgage in order that it may pass by it.

[4] Coe v. Pennock, 6 Am. L. Reg. 27; 2 Redf. Am. Ry. Cases, 667; Pennock v. Coe, 23 How. 117, 127. Mr. Justice Nelson, delivering the opinion of the Supreme Court, said: "If we are at liberty to determine this question by the terms and clear intent of the agreement of the parties, it will be found a very plain one. The company have agreed with the bondholders (for the mortgagee represents them) that, if they will advance their money to build the road and equip it, the road and equipments thus constructed, and as fast as constructed, shall be pledged as a security for the loan. This is the simple contract when stripped of form and verbiage; and, in order to carry out this intent most effectually, and with as little hazard as possible to the lender, the company specially stipulate that the money thus borrowed shall be faithfully applied in the construction and equipment of the road. And in further fulfillment of the intent, the company agree that, in case of default in payment of principal or interest, the bondholders may enter and take possession of the road, and run it themselves, by their agents, applying the net proceeds to the payment of the debt." The bondholders, he continued, have fulfilled their part of the agreement by advancing the money on the faith of the security; and the question is whether there is any rule of law or principle of equity that denies them the benefit of the security they contracted for. After examining the arguments against giving effect to a mortgage of after-acquired property, in conclusion he says that the court is satisfied that the mortgage attached to the future acquisitions, as described in it, from the time they came into existence.

A mortgage of a road and its fixtures, together with "all other property now owned and which may be hereafter owned by the railroad company," embraces cars, locomotives, and other rolling stock purchased by the company from time to time after the making of the mortgage.[5] In like manner a mortgage of an entire line of railroad, "with all the revenue or tolls thereof," was held to cover, not only the line of the road, but all the rolling stock and fixtures, whether movable or immovable, essential to the production of tolls and revenues.[6] The same view is expressed as to the effect of a mortgage by a railway company of "all the present and future to be acquired property of the company," "together with the tolls or income to be had or levied therefrom."[7] The latter clause seemed to be regarded as more decisive than the former that the rolling stock of the road was included. Applying the maxim, that whosoever grants a thing is supposed also, tacitly, to grant that without which the grant itself would be of no effect,[8] the tolls and income being expressly mortgaged, the rolling stock, which is essential to the production of tolls and income, must be included in the grant.

A mortgage of a "road and its franchise" was, however, regarded by the Supreme Court of Vermont as excluding from its operation the rolling stock, and other personal chattels that go to make up the

[5] Meyer v. Johnston, 53 Ala. 237, 332; 64 Ala. 603.

[6] Maryland v. Northern &c. R. Co. 18 Md. 193.

[7] Pullan v. Cincinnati &c. R. Co. 4 Biss. (U. S.) 35, 43. "On a foreclosure the lands, superstructures, and fixtures might, indeed, be sold; but the tolls and income could not be. Besides, the deed of trust provides another remedy to the mortgages in case of a default by the mortgagors,—the very remedy which the complainant is now seeking through a receiver. It provides that in case of a default the trustees may enter and take possession of the mortgaged property, and use and operate the same, and apply the proceeds thereof to the payment of the interest and principal of the bonds intended to be secured by the mortgage. Now, in pursuing this remedy, of what avail would all the other property be if the rolling stock cannot be used? Nay, could the remedy be pursued at all without the use of the rolling stock? The reason of the rule, that, when a man grants a tract of land in the centre of a larger tract owned by him, he also grants, by implication, a right of way into it, fully applies to the case in question; and it strongly applies to the mortgage of tolls and income."

[8] Cuicunque aliquis quid concedit, concedere videtur et id sine quo res ipsa esse non potuit. 11 Co. Rep. 52; Broom's Leg. Max. 479.

usual and necessary equipment and furnishing of the road, but not so affixed to the land as to partake of the character of realty.[9]

If rolling stock be regarded as an accession, in the nature of a fixture to the road, it passes by a mortgage of the road without express mention; and it is then immaterial whether it be in existence when the mortgage is given, or be afterwards acquired.

§ 124. **Many authorities, without going to the extent of holding that engines and cars are fixtures, regard them as so indispensable to the operation of a railroad** that they make a distinction between the rolling stock and other kinds of personal property, in respect to the rule that property not *in esse* cannot be conveyed. The rolling stock of a railroad is regarded as so appurtenant to the road, that when the company makes a mortgage of its road and franchise, it has a present existing interest in the rolling stock to be acquired for its use sufficient to uphold a grant of it as incident to the road. Their title to the road and franchise is the foundation of an interest in the cars and engines to be acquired for its use.[10] A lien, moreover, may be created without a grant. A contract intended as a grant, or one stipulating the making of a grant at a future time, may be upheld in equity as a present lien.

The York and Cumberland Railroad Company, in 1851, issued bonds secured by a mortgage, in trust, of its road and franchise, together with all "cars, engines, and furniture that may have been or may be purchased by said company." Some two years afterwards the company purchased an engine and certain cars, which they subsequently mortgaged. In 1859, a suit in equity was commenced in behalf of the bondholders under the first mortgage to compel the execution of the trust, and a receiver was appointed, who took possession of all the property of the company, including the engine and cars which were the subject of the second mortgage, and which were in daily use upon the road. The second mortgagee, after a demand for their surrender, brought an action of trover, and obtained leave of court to prosecute it. It was held that the lien of the existing mortgage attached to the rolling stock as soon as it was purchased and placed upon the road, and that the second mortgagee

[9] Miller v. Rutland &c. R. Co. 36 Vt. 452.

[10] Morrill v. Noyes, 56 Me. 458, 471.

acquired no title which he could maintain against the former mortgage.[11]

This decision might have been placed upon the ground that the mortgagee of the rolling stock had notice of the prior mortgage in which this property was also included; and in that case the question of the proper registry of the first mortgage would not be raised, for the knowledge of the second mortgagee of the existence of such mortgage would be equivalent to a due record of it.

A mortgage of a railroad, "together with the superstructure and tracks thereon, and all rails and other materials used thereon or procured therefor, and engines, tenders, cars, tools, materials, machinery, contracts, and all other personal property" then owned by it, or in future to be acquired, was held to include cars, wheels, firewood obtained for the use of the engines, and coal for the use of a machine-shop, as things incident and indispensable to the use and enjoyment of the principal thing conveyed.[12]

A mortgage lien upon rolling stock is not lost by withdrawing the property from present use upon the road for the purpose of repairing it, or of changing it to meet a contemplated narrowing of the gauge of the track.[13]

§ 125. A mortgage attaches to rolling stock subject to the liens existing upon it when it is acquired. The New Orleans and Ohio Railroad Company, having made a mortgage covering all future-acquired property, afterwards purchased of the United States certain locomotives and cars, for which it gave a bond stipulating that the United States should have a lien upon the property for the purchase money, and that the company should not part with it without written consent until payment of the price. The trustee for the bondholders claimed that the mortgage upon the road, being prior in date to the bond, attached to the property as soon as purchased, and displaced any junior lien. But the Supreme Court held that the mortgage attached itself to such property in the condition in which it came into the mortgagor's hands; that is, subject to the lien of the United States.[14]

[11] Morrill v. Noyes, 56 Me. 458.

[12] Phillips v. Winslow, 18 B. Mon. (Ky.) 431, 448; 68 Am. Dec. 729.

[13] Hamlin v. Jerrard, 72 Me. 62.

[14] United States v. New Orleans R. Co. 12 Wall. (U. S.) 362, 365.

§ 126. **In Alabama it is held that rolling stock so appertains to a railroad** as to become subject, on this ground, to a mortgage of it and its after-acquired property, whenever such property is acquired. Yet the rolling stock, as personal chattels not identified with the realty, does not become released from the liens under which the company has acquired it.[15] The Alabama and Tennessee River Railroad Company, in 1852, executed a mortgage of its road then constructed and to be constructed, and of all other property then owned and which might thereafter be owned by the company, together with its tolls and income. Some years afterwards this road was united with other roads, and a new name was given to the consolidated roads, and other mortgages were made by these. Upon a foreclosure of a subsequent mortgage it was held that the lien of the first mortgage extended to the cars, locomotives, and other personal movable property appertaining to the railroad; and that this

"If that property is already subject to mortgages or other liens, the general mortgage does not displace them, though they may be junior to it in point of time. It only attaches to such interest as the mortgagor acquires; and, if he purchase property and give a mortgage for the purchase money, the deed which he receives and the mortgage which he gives are regarded as one transaction; and no general lien impending over him, whether in the shape of a general mortgage, or judgment, or recognizance, can displace such mortgage for purchase money. And in such cases a failure to register the mortgage for purchase money makes no difference. It does not come within the reason of the registry laws. These laws are intended for the protection of subsequent, not prior, purchasers and creditors. Had the property sold by the government to the railroad company been rails, as in the case of the Galveston Railroad v. Cowdrey, 11 Wall. 459, or any other material which became affixed to, and a part of, the principal thing, the result would have been different. But, being loose property, susceptible of separate ownership and separate liens, such liens, if binding on the railroad itself, are unaffected by a prior general mortgage given by the company, and paramount thereto. In the case before us the United States, at the time of making the sale, reserved a lien on the property, and imposed a conditon of nonalienation until the price should be paid. Taken altogether, the transaction amounts to a transfer sub modo, and the lien must be regarded as attaching to the property itself, and as paramount to any other liens arising from the prior act of the company." Per Bradley, J. See, also, Boston Safe &c. Co. v. Bankers &c. Tel. Co. 36 Fed. 288.

[15] Meyer v. Johnston, 53 Ala. 237, 324, 353; 64 Ala. 603.

lien was not restricted to so much of the rolling stock as remained of what the company owned at the time of the consolidation. If the company had then ceased to exist, the lien of the mortgage would not have attached to any rolling stock acquired afterwards, because the acquisition would not have been made by the mortgagor; but, as the court held that this company continued its existence after the consolidation under a new name, it necessarily followed that the mortgage given by it embraced the rolling stock held at the time of the foreclosure to the same extent, or in the same proportion, that it embraced the railroad itself.[16]

In 1873 the receivers were authorized, pending the foreclosure suit, to buy a large quantity of rolling stock, and for that purpose to issue certificates and make them a prior lien upon the road and property. Some part of the rolling stock so purchased was already upon the road, and in use by it under contracts and leases; and it was contended by some of the mortgage creditors that such rolling stock, although not paid for by the company, became subject to the liens of the mortgages when put upon the mortgaged road; and, moreover, that even the new rolling stock purchased by the receivers, and put upon the road by them under authority of the court, became subject to the liens of the mortgages in preference to the liens authorized by the court in the order for purchase. But the court held that the lien authorized by the court could not be superseded or lessened by the mortages; that, while it is true that when a railroad company which has executed several successive mortgages of its road, equipments, and appurtenances, purchases and puts upon its road rolling stock which is then free from all liens, this property so appertains to the road as to become subject to the mortgages which have priority, according to the date of their execution; yet such property does not become so identified with the realty by being placed upon it that it is released from the liens attaching to it when it was acquired. Liens upon the rolling stock existing upon it when it comes into the mortgagor's lien possession remain binding upon it, and superior to those of the mortgage existing at the time upon the railroad.[17]

[16] Meyer v. Johnston, 53 Ala. 237, 324, 353; 64 Ala. 603.

[17] Meyer v. Johnston, 53 Ala. 237, 352; 64 Ala. 603.

§ 127. **It may, therefore, be regarded as judicially settled,** with little or no divergence of opinion, that in equity a mortgage of a railroad will be held to apply to after-acquired rolling stock, and other personal property, if the terms of the mortgage cover such future acquisitions; with the qualification, however, that the mortgage will attach to such property subject to the liens existing upon it when it comes into the hands of the mortgagor.

II. *Mortgages of After-acquired Rolling Stock as affected by Conditional Sales.*

§ 128. **The validity of a conditional sale,** the vendor reserving the thing sold till it is paid for, is everywhere conceded as between the parties; and at common law and in most of the states the contract is valid, and the title of the vendor is good as against purchasers from the vendee and against his creditors. In a few states the title of the vendor who has delivered possession to the vendee is invalid as against purchasers from the latter without notice, and as against his creditors.[18] In several states that there are general statutes requiring the recording of conditional sales in order to make them valid as against third persons. In several states special statutes have been enacted within a few years past to make valid conditional sales of rolling stock. These statutes provide in substance that contracts for the sale or lease of rolling stock, with a reservation of title to the vendor until full payment of the purchase price is made, shall not be valid as against judgment creditors of the vendee or purchasers without notice, unless the contracts be in writing and be acknowledged and recorded. They also usually provide that the engines or cars sold or leased shall be marked with the name of the vendor. Such statutes, it is believed, have now been enacted[19] in

[18] **Pennsylvania:** Forrest v. Nelson, 108 Pa. St. 481; Stadtfeld v. Huntsman, 92 Pa. St. 53; 37 Am. R. 661.

Illinois: Murch v. Wright, 46 Ill. 487; 95 Am. R. 455; Hervey v. Rhode Island &c. Works, 93 U. S. 664.

Kentucky: Greer v. Church, 13 Bush (Ky.) 430.

[19] Such statutes exist in:—

Alabama: Code 1886, §§ 1821, 1822; Code 1896, §§ 1016, 1017. As to counties, Jefferson and Montgomery, see Local Acts 1898–99, No. 573, as to record.

nearly all the states in which conditional sales are not valid under common law decisions.

Arizona: Laws 1905, ch. 129, § 1.

Colorado: Laws 1885, p. 302.

Delaware: Laws 1883, ch. 146; R. C. 1893, p. 552.

Georgia: Code 1895, vol. 2, §§ 2326–2328.

Idaho: Laws 1905, p. 154.

Illinois: Annot. Stats. 1885, ch. 114, § 84; R. S. ch. 114, §§ 52–54.

Indiana: Acts 1889, ch. 176.

Iowa: Anno. Stats. 1897, §§ 2051, 2052.

Kentucky: Carroll's Stats. 1903, §§ 2496–2497.

Louisiana: Wolff's R. L. 2nd Ed. 1904, vol. 2, p. 1483. Act. III.

Maine: R. S. 1903, p. 541, §§ 95, 96.

Massachusetts: R. L. 1902, §§ 75, 76. Acts 1906, ch. 463, pt. 1, §§ 59, 60.

Maryland: Pub. Gen. Laws 1889, art. 21, § 84; Laws 1882, p. 317; Pub. Gen. Laws 1904, vol. 1, p. 527, art. 87.

Michigan: Comp. Laws 1897, vol. 2, §§ 6336, 6337.

Minnesota: Laws 1885, ch. 210; 2 G. S. (Supp.) 1888, ch. 34, §§ 91d–91h; R. L. 1905, §§ 2904–2906.

Mississippi: Code 1906, §§ 4103–4106.

Missouri: R. S. 1899, § 1182.

Montana: Comp. Stats. 1887, ch. 36, §§ 709, 710, 711; Codes 1895, §§ 930–936.

Nebraska: Comp. Stats. 1905, §§ 3661–3664.

New Hampshire: Laws 1901, pp. 448, 449.

New Jersey: R. S. Supp. 1877–1886, p. 846; G. S. 1895, vol. 2, p. 2706, arts. 295–299.

New Mexico: Comp. Laws 1884, § 2739; Comp. Laws 1897, § 3919.

New York: 4 R. S. 1889, p. 2521; Session Laws 1897, vol. 1, p. 539; Heydeckers' G. L. 1901, 2nd Ed. vol. 3, p. 4027, § 111.

North Carolina: 1 Code 1883, § 2006; Laws 1883, ch. 416; Revisal 1905, vol. 1, § 984.

North Dakota: R. C. 1895, §§ 2959–2960.

Ohio: R. S. 1884, p. 170; Act of March 16, 1882; Bates' Annot. Stat. 5th Ed. vol. 2, § 3378.

Oklahoma: R. S. 1903, vol. 1, §§ 139–140.

Oregon: 2 Annot. Laws 1887, §§ 4042, 4043; Annot. Codes, §§ 5137–5138.

Pennsylvania: 2 Brightly Purdon Dig. 1883, p. 1422, § 42; Stat. Law of Corp. 1902; Whitworth & Miller, § 1023.

Rhode Island: G. S. 1896, p. 603, § 57; Sess. Laws 1893, ch. 1160, §§ 1–3.

South Carolina: R. S. 1893, §§ 1550, 1551.

South Dakota: Comp. Laws 1897, §§ 2982, 2983; Annot. Stats. 1901, §§ 3902, 3903.

Tennessee: Acts 1885, ch. 96; Code Supp. 1903, §§ 3587, 3589.

Texas: Sayles Civil Stats. 1897, § 3328; Supp. 1906, §§ 3327–3328.

Utah: R. S. 1898, ch. — § 168; Laws 1905, ch. 4.

Vermont: R. S. 1894, § 3804–3805.

Virginia: Code 1887, § 2462; Pollard's Code, 1904.

Washington: Laws 1883, p. 62: Codes and Stats. 1897, § 4588.

§ 129. Rolling stock contracts differ in form and legal effect. In legal effect they are generally conditional sales. The form may be that of a lease; but if the real character of the contract was not a bailment, but a sale, and the "rent" reserved was really instalments of purchase money, the title remaining in the "lessor" until such instalments should be paid, the courts, looking at the real character of the contracts rather than the form, will hold them to be conditional sales.[20]

Under a contract that payment for a locomotive shall be made at the time of delivery, the seller may take the property back when, upon delivery, the railroad company neglects or refuses to pay; the delivery being subject to a condition and not absolute, so as to transfer the title. But the vendor cannot allow the property to remain in the possession and use of the vendee as a purchaser and proceed to enforce payment by ordinary legal remedies, without being deemed to waive the condition. The title then passes absolutely

West Virginia: Annot. Code 1906, §§ 3101–3108.

Wisconsin: Laws 1883, ch. 274; Annot. Stats. § 1839a.

Wyoming: R. S. 1899, § 2839.

The provisions in such statutes for recording the contract and marking the rolling stock have been held not to apply to sales of parts of rolling stock, such as trucks and motors for use on a street railway; and the conditonal sale may be enforced against a mortgagee or purchaser who had no notice of the conditonal sale. Lorain Steel Co. v. Norfolk &c. R. Co. 187 Mass. 500; 73 N. E. 646.

On this subject see the learned paper by Francis Rawle, Esq., of Philadelphia, on Car Trust Securities, read before the American Bar Association and published in vol. 8 of its Reports, p. 277.

[20] Hervey v. Rhode Island &c. Works, 93 U. S. 664; Heryford v. Davis, 102 U. S. 235; Myer v. Car Co. 102 U. S. 1. See, also, Whitcomb v. Woodworth, 54 Vt. 544; Murch v. Wright, 46 Ill. 487; Singer Mfg. Co. v. Graham, 8 Oreg. 17; Singer Mfg. Co. v. Cole, 4 Lea (Tenn.), 439; 40 Am. R. 20; Bean v. Edge, 84 N. Y. 510; Loomis v. Bragg, 50 Conn. 228; 47 Am. R. 638; Hine v. Roberts, 48 Conn. 267; 40 Am. R. 170; Sumner v. Cottey, 71 Mo. 121; Domestic Sewing Mach. Co. v. Anderson, 23 Minn. 57; Carpenter v. Scott, 13 R. I. 477; Humphreys v. St. Louis &c. R. Co. 5 Railw. Corp. L. J. 149.

In **Pennsylvania** and **Alabama**, however, such a contract is considered as a bailment for hire, rather than a conditional sale. Forrest v. Nelson, 108 Pa. St. 481, 486, per Sterrett, J.; 19 Rep. 380; Enlow v. Klein, 79 Pa. St. 488; Rowe v. Sharp, 51 Pa. St. 26; Henry v. Patterson, 57 Pa. St. 346; Becker v. Smith, 59 Pa. St. 469; McCall v. Powell, 64 Ala. 254.

to the railroad company and the property becomes subject to the lien of existing mortgages.[21]

§ 130. **The nature and effect of a car-trust contract is to be determined by the intention of the parties,** as gathered from the whole instrument, the situation of the subject-matter of the contract, and the circumstances surrounding the transaction, and not merely from the name the parties give to it.[22] Thus, where a manufacturer of cars contracted to loan certain cars to a railroad company for hire at a stipulated price payable in instalments, for which the company executed its notes, on the payment of which the car company was to relinquish the cars to the company, and on default in the payment of the notes the car company might at its option retake the cars and sell them, retaining for its own use all payments received up to that time, keeping the amount unpaid out of the proceeds and returning the surplus, if any, to the railroad company, it was held that the transaction was neither a loan nor a conditional sale of the cars, but a hypothecation of them to secure the price of them.[23] Mr. Justice Strong, speaking for the court, said: "The form of the instrument is of little account. Though the contract industriously and repeatedly spoke of loaning the cars to the railroad company for hire for four months, and delivering them for use for hire, it is manifest that no mere bailment for hire was intended. . . . We can come to no other conclusion than that it was the intention of the parties, manifested by the agreement, that the ownership of the cars should pass at once to the railroad company in consideration of their becoming debtor for the price. Notwithstanding the efforts to cover up the real nature of the contract, its substance was an hypothecation of the cars to secure a debt due to the vendors for the price of a sale."

§ 131. **Priority of title under conditional sales.**—The rights of a

[21] Manchester Locomotive Works v. Truesdale, 44 Minn. 115; 46 N. W. 301; 9 L. R. A. 140n.

[22] Heryford v. Davis, 102 U. S. 235; Frank v. Denver &c. R. Co. 23 Fed. 123; Central Trust Co. v. Ohio &c. R. Co. 36 Fed. 520; Hervey v. Rhode Island &c. Works, 93 U. S. 664; Fidelity Ins. &c. Co. v. Shenandoah &c. R. Co. 86 Va. 1; 9 S. E. 759.

[23] Heryford v. Davis, 102 U. S. 235.

person who furnishes rolling stock under a valid conditional sale, or a stipulation for a lien, are superior to those of a prior mortgagee claiming a lien upon or title to such rolling stock as after-acquired property.[24]

In a Pennsylvania case the owner of rolling stock entered into a written agreement with a railway company to rent the rolling stock to the company for eight years, at an annual rental, with an option to purchase, the rent to apply on purchase money. This lease was not recorded. After this a mortgage prior in date to the lease was foreclosed and the property covered by the lease sold. The court, applying the Pennsylvania rule, held that the lease constituted a bailment for hire, and that the lessor's title was not divested by the sale under the mortgage. The measure of damages recoverable by the lessor was the value of the property as stipulated in the bailment contract, mitigated by the amount of rent already paid.[25]

If, however, the rolling stock, though nominally leased by the railway company, is acquired under an arrangement which amounts in law to a purchase of it, there is no rule of law which will estop the mortgagee or a purchaser at a foreclosure sale from insisting that the railway thereby acquires the title to the property, and that it has become subject to the lien of a mortgage covering after-acquired property. The mortgagee is not bound by the construction put upon the contract by the mortgagor. It would be a strange anomaly if the very parties against whom the alleged device was directed were estopped to take advantage of it by the acts of a corporation represented and controlled by directors, who were themselves parties to it.

§ 132. If the transaction amounts merely to a loan, secured by mortgage bonds, though called car-trust certificates, giving a lien upon rolling stock which had already become the property of the railroad company, such certificates will be inferior in point of lien to a prior mortgage which applies to after-acquired property. A

[24] United States v. N. O. R. Co. 12 Wall. (U. S.) 362; Fosdick v. Schall, 99 U. S. 235; Meyer v. Car Co. 102 U. S. 1; Fidelity Ins. &c. Co. v. Shenandoah &c. R. Co. 86 Va. 1; 9 S. E. 759; Central Trust Co. v. Marietta &c. R. Co. 48 Fed. 865.

[25] Collins v. Bellefonte R. Co. 171 Penn. St. 243; 33 Atl. 331.

contract between the trustee of an alleged car-trust and a railroad company provided for a lease of rolling stock by the former to the latter at an annual rent for the period of ten years, at the end of which time the leased rolling stock should become the property of the railroad company. The trustee at the time of the execution of the lease neither owned nor possessed the rolling stock proposed to be leased. After the execution of the lease the railroad company furnished to the trustee the names of subscribers to the car-trust certificates; and thereupon the trustee made out subscription certificates which entitled the holders to a certain amount of car-trust certificates when the subscriptions should be paid in full. The money paid on the subscriptions was credited on the subscription certificates, and deposited in bank to the credit of the equipment account of the railroad company. When the subscriptions were fully paid, the railroad company scheduled the rolling stock under the lease, and the trustee certified the car-trust certificates and turned them over to the holders. The railroad company obtained the rolling stock under its own contracts with the car-builders, or itself constructed it. The car-trust association was constituted merely of the subscribers, who received the railroad company's bonds with interest coupons attached, secured by mortgage upon certain described rolling stock which the company expected to construct or acquire by purchase, and which it was to designate, after it was acquired, in a schedule to be furnished the trustee. The court declared that the transaction was neither a contract of bailment, contemplating merely the use of the equipment by the railroad company, nor a conditional sale of such equipment.[26]

[26] Central Trust Co. v. Ohio &c. R. Co. 36 Fed. 520; 36 Am. & Eng. R. Cas. 299, 319. "If a transaction of this character, and conducted as this business was, can be sustained, and held to confer superior rights to the lien of prior mortgages containing 'after-acquired property' clauses sufficiently broad to cover the same property, then such 'after-acquired property' clauses of mortgages will become idle and useless provisions, because, by the easy contrivance of so called 'car-trusts' and 'car-trust certificates' of the mortgagor, all subsequently acquired property may be readily taken out of their operation." Per Jackson, J. See, however, Frank v. Denver &c. R. Co. 23 Fed. 123, where it was held that a mortgage of after-acquired property was subject to an agreement for a lien on rolling stock in behalf of one who had furnished money to enable

If the property, though nominally leased by the railway company, was acquired under an arrangement which amounted in law to a purchase of it, there is no rule of law which will estop the mortgagee or purchaser at a foreclosure sale from insisting that the railway thereby acquired the title to the property, and that it had become subject to the lien of the mortgage. The mortgagee is not bound by the construction put upon the contract by the mortgagor.[27]

§ 133. **If a railroad company buys or constructs rolling stock for its own use with money furnished by a car-trust company,** under a contract in the form of a lease, the rolling stock being nominally delivered to the car-trust company, and by the latter delivered back to the railroad company, the transaction is really a lien in the nature of a mortgage, under the disguise of a conditional sale. If the contract in regard to rolling stock is not acknowledged and recorded in accordance with the provisions of the statute relating to chattel mortgages, it will not be established as a lien on such property as against a prior mortgage of the railroad and franchises covering also after-acquired property, or as against creditors of the railroad company proceeding by attachment and execution, or as against purchasers from the railroad company in good faith. The transaction would be only a lien created by contract, which a court of equity would enforce only in case there were no prior legal or equitable rights in others.[28]

§ 134. **A covenant in a mortgage of a division of a line of railroad, with the rolling stock belonging to it, to designate such rolling stock in a certain way,** may possibly be specifically enforced as against the mortgagor, but it cannot be so enforced as against subsequent mortgagees whose mortgages have attached to the rolling stock of the whole line of road before there has been any designation under the prior mortgage. Thus where the covenant was to designate in a certain mode, as belonging to the division mortgaged, such a proportion of the whole rolling stock owned by the

the railroad company to purchase it.

[27] McGourkey v. Toledo &c. R. Co. 13 Sup. Ct. (Ohio) 170.

[28] Frank v. Denver &c. R. Co. 23 Fed. 123; Central Trust Co. v. Ohio &c. R. Co. 36 Fed. 520.

mortgagor as that division bore to the entire line, it was held that the divisional mortgage covered only such rolling stock as was thereafter designated as belonging to the division named, though the proportion covenanted for was never so designated. The court would not be justified in attempting to enforce the covenant in the manner provided as against subsequent mortgages.[29] But rolling stock purchased and designated for the division named is covered by such divisional mortgage, and the lien is not lost by subsequent obliteration of the designations, where such rolling stock is otherwise traceable, either as against the mortgagor or as against subsequent purchasers at a sale under a subsequent mortgage of the entire railroad property and appurtenant rolling stock, who take with full notice of the lien of the former mortgage.[30]

§ 135. The validity of a mortgage or conditional sale of a chattel is, as a general rule, determined by the lex rei sitae. If the mortgage or sale was valid where the property was situated at the time of the transaction, it is valid as against an attachment made in another state, though the mortgage was not filed or recorded, or though the sale was not made as required by the laws of the state where the attachment was made.[31]

In the absence of proof to the contrary, it is to be assumed that such personal property was at the time of the execution of the mortgage in the state where the corporation was organized, and where the mortgage was executed.[32]

III. *Rolling Stock regarded as Fixtures.*

§ 136. There are many considerations why rolling stock should be regarded as strictly of the nature of fixtures. It is fitted to the gauge of the road and adapted particularly for use upon it. With-

[29] United States Trust Co. v. Wabash &c. R. Co. 38 Fed. 891.

[30] United States Trust Co. v. Wabash &c. R. Co. 38 Fed. 891.

[31] Hervey v. Rhode Island &c. Works, 93 U. S. 664; Green v. Van Buskirk, 5 Wall. (U. S.) 307; Rogers &c. Works v. Lewis, 4 Dill. (U. S.) 158; Hart v. Barney & Smith Mfg. Co. 7 Fed. 543, 550; Homans v. Newton, 4 Fed. 880, 885; Hirschorn v. Canney, 98 Mass. 149; Bank v. McLeod, 38 Ohio St. 174; Nichols v. Mase, 94 N. Y. 160; Jones Chattel Mortgages, § 305.

[32] Nichols v. Mase, 94 N. Y. 160.

out it the road is not only worthless to the company, but it ceases to be of use to the public, which is one of the purposes for which the company was chartered. The fact that the rolling stock is not actually attached to the land, but may be transferred to another road and used upon that equally well, is not decisive against its being a fixture. The manner and degree of annexation to the realty is only one element in determining whether any article of personal property is a fixture or not; while the intention of the parties with reference to making it a permanent accession to the freehold, and its adaptation to the use and purpose for which it is attached, are considerations of equal importance, at least, in determining the question. These considerations are to be unitedly applied.[33]

[33] Rolling Stock has been regarded as a fixture or part of the realty in the following cases in the United States Courts: Pennock v. Coe, 23 How. (U. S.) 117; Gue v. Tidewater Canal Co 24 How. (U. S.) 257; Minnesota Co. v. St. Paul Co. 2 Wall. (U. S.) 609; Railroad Co. v. James, 6 Wall. (U. S.) 750; Scott v. Clinton & S. R. Co. 6 Biss. (U. S.) 529; Farmers' &c. Co. v. St. Joseph &c. R. Co. 3 Dill. (U. S.) 412.

Kentucky: Elizabethtown &c. R. Co. v. Elizabethtown, 12 Bush (Ky.) 233; § 142.

Pennsylvania: Youngman v. Elmira &c. R. Co. 65 Pa. St. 278; § 159. In this state, however, the ground of exemption of rolling stock from levy is public policy, rather than an application of the doctrine of fixtures.

Tennessee: Buck v. Memphis &c. R. Co. 4 Cent. L. J. (Mo.) 430; § 143.

So declared by statute in Dakota, § 154; Florida, § 155; Iowa, § 156; Minnesota, § 158; Nebraska, § 160; Utah Territory, § 164; Vermont, § 165.

In several states mortgages by railroad companies are by statute made effectual to cover rolling stock. California, § 152; Connecticut, § 153; Massachusetts, § 157; Montana, §159; New Jersey, § 161; New York, § 162; Ohio, § 163; and West Virginia, § 166.

Rolling stock is declared not to be a fixture or part of the realty, but personalty, in,—

Iowa: Neilson v. Iowa Eastern R. Co. 51 Iowa, 184; 1 N. W. 434; 33 Am. R. 124.

New Hampshire: Boston &c. R. Co. v. Gilmore, 37 N. H. 410; 72 Am. Dec. 336.

New Jersey: Williamson v. New Jersey &c. R. Co. 29 N. J. Eq. 311. See § 161.

New York: Randall v. Elwell, 52 N. Y. 521; 11 Am. R. 747; Hoyle v. Plattsburgh R. Co. 54 N. Y. 314; 13 Am. R. 595; § 162.

Ohio: Coe v. Columbus &c. R. Co. 10 Ohio St. 372; § 163.

Wisconsin: Chicago &c. R. Co. v. Ft. Howard, 21 Wis. 44; 91 Am. Dec. 458.

So by constitutional provision in Illinois, Missouri, Arkansas, Nebraska, Texas, and West Virginia, § 151.

§ 137. The actual fastening of a movable article to the freehold is not essential to its becoming a fixture. "If a billiard-table be fastened to the floor so as to be conceded a fixture, would not the balls, and cues pass also? A bucket in a well may be detached, and it is movable, running from top to bottom of the well, yet it is a fixture by common consent. A shuttle in a loom is thrown from place to place by the motive power of the machinery, yet it is an essential part of the machine." In the cases mentioned, the billiard-balls, the bucket, and the shuttle are fixtures solely because they are essential to the use of the property of which they are parts, although disconnected parts. In like manner the cars and engines of a railroad are essential to the use of the road. "The right to buy and own rolling stock is a franchise, and can only be exercised as an accessory to the operation of a railroad. Any buying or selling of cars, engines, and the like, by the company, for the mere purpose of speculation, would be unauthorized and illegal. Here, then, is a consideration showing that a company intends the rolling stock to be used only for the road, or, in other words, to become a permanent accession to the real estate of the company. The intention of the owner, the use for which the property was designed, the connection between the road and the cars, and the essential relation between them for the purpose of revenue, all combine to declare the rolling stock real estate."[34]

§ 138. Statutes in regard to acknowledging and recording chattel mortgages do not ordinarily embrace mortgages by railroads of personal property used and appropriated for railroad purposes, when such mortgages cover such personal property in connection with the corporate real estate and franchises.[35] Thus, where a mortgage covered the rolling stock and other property appertaining to a railroad company, and the mortgage had been duly recorded as a real estate mortgage, but not as a chattel mortgage, certain judgment

[34] Minnesota Co. v. St. Paul Co. 2 Wall. (U. S.) 609, note, p. 648, on rolling stock as a fixture, being an extract from brief of Mr. Carpenter.

[35] Hammock v. Loan & Trust Co. 105 U. S. 77; Cooper v. Corbin, 105 Ill. 224; Peoria & Springfield R. Co. v. Thompson, 103 Ill. 187; Farmers' &c. Co. v. Detroit &c. R Co. 71 Fed. 29.

creditors of the mortgagor levied upon the rolling stock embraced in the mortgage; and the question was whether their rights were prior to those of the mortgagees.[36] The court held that it was not necessary, as to the rolling stock, to record the instrument as a chattel mortgage. As to this it was sufficient, even as to creditors, that the mortgage was duly registered as a mortgage of real estate. The rolling stock and other property strictly and properly appurtenant to the road is part of the road and covered by the mortgage in question, which in terms embraces rolling stock. The opinion of the court does not clearly indicate whether the registry was considered sufficient, on the ground that the rolling stock is a fixture, or on the ground that such property does not come within the purview of the statute relating to the record of chattel mortgages; but it would seem to be on the former ground.

The La Crosse and Milwaukee Railroad Company, in 1856, mortgaged the western division of its road, from Portage to La Crosse, a distance of 105 miles; and in the following year mortgaged its eastern division, from Milwaukee to Portgage, a distance of 95 miles, to secure other bondholders; and again, in the next following year, executed a mortgage of the whole line of its road from Milwaukee to La Crosse to secure another issue of bonds. Each mortgage embraced "all and singular the locomotive engines and other rolling stock, and all other equipments of every kind and description which have already been or may hereafter be procured for or used on said road;" and each was in terms made subject to all prior mortgages of the road. The rolling stock was purchased with the funds of the company, and was placed and used on the entire line of the road, embracing both divisions, and no apportionment of it was made between the two divisions. It was held, therefore, that the mortgages operated upon all the rolling stock in the order of their dates; and that the mortgage of the western division, being the oldest, had priority of lien upon the entire rolling stock of the company.[37]

It is possible, however, for a railroad company owning the whole of a long road, and all the rolling stock upon it, to assign certain cars and engines to particular divisions of the road, so that such rolling stock would attend such divisions and pass by separate mort-

[36] Farmers' &c. Co. v. St. Joseph &c. R. Co. 3 Dill. (U. S.) 412.

[37] Minnesota Co. v. St. Paul Co. 6 Wall. (U. S.) 742.

gages of them. Whether in any particular case a railroad company had divided its rolling stock and mortgaged it in this way is a question of intention.[38]

§ 139. In Illinois it was settled that rolling stock is a fixture which passes by a mortgage of the road,[39] by several cases decided as early as 1860 and 1861. As a part of the realty, such property was not subject to the laws relating to mortgages of personal chattels. Locomotives and cars in and upon the road, or intended for immediate use upon it, could not be taken on execution by a creditor and severed from the road so as to change them into personalty. If this could be done, say the court, in one case, houses, fences, timber, fruit-trees, and almost every description of improvements might in the same way be converted into personalty.[40] In all the cases it seemed it be taken as an unquestioned doctrine that the rolling stock passed as a portion of the realty.

Thus stood the law on this subject until the Constitution of 1870[41] provided that "rolling stock, and all other movable property belonging to any railroad company or corporation in this state, shall be considered personal property, and shall be liable to execution and sale in the same manner as the personal property of individuals, and the general assembly shall pass no law exempting any such property from execution and sale." But even this provision was declared by the Circuit Court of the United States not to change the rule that a mortgage made by a railroad company, covering all after-acquired property, includes rolling stock, if the mortgage was given before the rights of execution creditors attach.[42] Such a mortgage seizes

[38] Minnesota Co. v. St. Paul Co. 2 Wall. (U. S.) 609.

[39] Palmer v. Forbes, 23 Ill. 301, 302; Hunt v. Bullock, 23 Ill. 320; Titus v. Mabee, 25 Ill. 257; Titus v. Ginheimer, 27 Ill. 462. See, however, an earlier case, in which it was held that a road and its furniture do not constitute one thing; that the furniture of a road is no more a part of the road than is the furniture of a house a part of a house. Sangamon &c. R. Co. v. Morgan Co. 14 Ill. 163; 56 Am. Dec. 497.

[40] Titus v. Mabee, 27 Ill. 462, per Walker, J.

[41] Art. 11, § 10; Annot. Stats. 1885, p. 1915.

[42] Scott v. Clinton &c. R. Co. 6 Biss. (U. S.) 529. See Union Trust Co. v. Morrison, 125 U. S. 591; 8 Sup. Ct. 1004.

the property or operates on it by way of estoppel as soon as it comes into existence and is in the possession of the mortgagor, and confers an equity prior to claims under judgments and executions subsequently obtained. The principle is the same whether the property be regarded as real or personal.

§ 140. That the franchise, lands, and property of corporations chartered for the use and accommodation of the public cannot be levied upon, or sold under execution, has been declared by numerous authorities, on the ground that the value and usefulness of the entire corporate property, and of the corporate franchise, would thus be destroyed. This was the view taken by the Supreme Court of the United States in the case of Gue v. Tide Water Canal Company.[43] The property levied on in this case was, however, land and fixtures,

[43] 24 How. (U. S.) 257, 263. Chief Justice Taney, delivering the opinion of the court, said: "The property seized by the marshal is of itself of scarcely any value, apart from the franchise of taking toll, with which it is connected in the hands of the company; and if sold under this fieri facias, without the franchise, would bring scarcely anything; but would yet, as it is essential to the working of the canal, render the property of the company in the franchise, now so valuable and productive, utterly valueless. Now, it is very clear that the franchise or right to the toll on boats going through the canal would not pass to the purchaser under this execution. The franchise being an incorporated hereditament cannot, upon the settled principles of the common law, be seized under a fieri facias. If it can be done in any of the states, it must be under a statutory provision of the state; and there is no statute of Maryland changing the common law in this respect. Indeed, the marshal's return and the agreement of the parties show it was not seized, and consequently, if the sale had taken place, the result would have been to destroy utterly the value of the property owned by the company, while the creditor himself would, most probably, realize scarcely anything from those useless canal-locks and lots adjoining them. The record and proceedings before us show that there were other creditors of the corporation to a large amount, some of whom loaned money to carry on the enterprise. And it would be against the principles of equity to allow a single creditor to destroy a fund to which other creditors had a right to look for payment, and equally against the principles of equity to permit him to destroy the value of the property of the stockholders by dissevering from the franchise property which was essential to its useful existence."

such as canal-locks, admitted to be necessary to the working of the canal. The sheriff being about to sell the property, the company filed a bill, praying for an injunction against the sale, which was granted and made perpetual by the Circuit Court, and, on appeal, this decree was affirmed.

§ 141. **In Pennsylvania the policy of the law with reference to the levying of executions upon a railroad** or its appurtenances has been declared in several cases to be, that any property of the corporation necessary to the exercise of the franchises granted to it cannot be levied on and sold under an execution on a judgment against the corporation.[44]

In one case, in which a levy upon loose rails and chairs intended for use in repairing a railroad was called in question, it was held that, even if the rails and chairs be not regarded as affixed to the realty, but as standing to the road in the same relation as the rolling stock,—personalty by nature, but appurtenant by use, and necessary to operate the road,—considerations of public policy forbid the levy and sale on execution of such articles. Independently of the public purpose for which they are used, doubtless such property is liable to seizure.[45]

[44] Youngman v. Elmira &c. R. Co. 65 Pa. St. 278; Shamokin Valley R. Co. v. Livermore, 47 Pa. St. 465; Susquehanna Canal Co. v. Bonham, 9 Watts & S. (Pa.) 27. See, also, Macon &c. R. Co. v. Parker, 9 Ga. 377.

[45] Covey v. Pittsburgh &c. R. Co. 3 Phila. (Pa.) 173, 178, 179; 49 Am. Dec. 552. This view of the subject was forcibly presented in the Court of Common Pleas of Pennsylvania by Mr. Justice Agnew, afterwards of the supreme bench of that state: "A railroad corporation is but a servant of the state, and, while it has its private ends, it must obtain them through a faithful discharge of its obligation to the public, for whose benefit its powers are conferred. Its charter is not only the grant of its own privileges, but it is the evidence of their consideration arising in the public benefit, and of its contract to subserve this purpose. For this, and this alone, the state imparts a portion of its sovereign power, and invests it with high privileges. So completely subservient is it to the public good, so clearly a trustee for a general purpose, its own property may be taken and used to fulfill a higher public use. So much is the notion of a public trust involved in every such a charter that every doubt in its interpretation is resolved in favor of the public, and against the private interest. If, besides their rails and their sup

Consistent, perhaps, with the foregoing are late cases in that state, in which it was held that, although cars, horses, harnesses, and other personal property of a passenger railway company, cannot be seized on execution as against a mortgagee of the property, or as against the general creditors of the company after its insolvency, yet in such cases the equity which would restrain a sale at law springs from the fact of insolvency or from the trusts created by the mortgage.[46]

porting chairs actually imbedded in the track, the company may not maintain deposits of others, at convenient intervals, for immediate repair, and if, because they thus lie in piles, they may be seized all along the route by successive writs, the usefulness of the railway as a public work must cease. If it may be dismantled by attacking it in detail and seizing those things most easily removed, though essential to its preservation, it would be but a step to the end; when stripped of all but its roadbed and fixtures, it would be powerless to serve the public or benefit itself.

"The purpose of a railroad, the nature of its property, the necessity of possession to accomplish its purpose, and the powers conferred in the charter, leave no room to doubt the validity of a mortgage, without delivery of possession, of those chattels which are necessary to carry out the object of incorporation. Though the body is private, the object is public; and it is clothed with a portion of the sovereign power to accomplish this. . . . Having conferred the power to borrow money and mortgage the property to carry out an object of great public utility, it would be absurd to suppose the legislature meant, in the teeth of its purpose, to require a delivery of the property necessary for this purpose, in order to make the mortgage effectual, while the mortgagees are under no duty to operate the road."

[46] Mr. Justice Woodward, of the Supreme Court of Pennsylvania, in a nisi prius case, said: "Where, however, the question is presented independently both of insolvency and mortgage trusts,—where the exemption from levy and sale is claimed on no other ground than that of accession to the corporate franchise,—I cannot agree that rolling stock and equipments are as much exempt as the rails of the road. I know of no reason why a railway company's horses and carriages may not be seized in execution by a judgment creditor in the same manner as the horses and carriages of any other debtor; no reason, I mean, that is intrinsic and self-existent in the economy of the corporation. Reasons may arise out of the equities created in favor of other parties by a state of insolvency, or the fact of a mortgage; but apart from these considerations —considering a railroad company with reference only to its judgment and execution creditors—I suppose it holds its personal property, as all other debtors do, subject to levy and sale for debts. It is at-

§ 142. **In Kentucky also personal property essential to the operating of a railroad** is held not to be subject to execution. Such seizures and sales are thought to lead to results too mischievous to be tolerated.[47]

It is accordingly held that the cars of a railway company are not subject to seizure and sale by a ministerial officer, even for taxes. They are treated as fixtures of its road. The collection of these taxes can be enforced only under the supervision of a court of equitable jurisdiction, in the same manner as the claims of creditors of the company are enforced.[48]

§ 143. **In Tennessee** it has been held that under a mortgage of the main line of a railroad situated in the State of Arkansas, and covering all rolling stock, appurtenances, and income, cars from the

tempted to apply the doctrine of fixtures, and to treat everything as part of the company's freehold which is essential to the carrying on of its appropriate business. That doctrine has never been so applied anywhere, I believe,—certainly not here in Pennsylvania." In the case before the court, there being a question whether the company had power to mortgage, the court, without deciding this, enjoined the levying of the execution until further order, but directed that the lien should continue in the mean time. Loudenschlager v. Benton, 3 Grant, 384, 385; 4 Phila. (Pa.) 382; Brill v. West End &c. R. Co. 4 Wky. N. Cas. 139.

[47] Phillips v. Winslow, 57 (Ky.) 431, 448; 68 Am. Dec. 729; and see Douglass v. Cline, 75 Ky. 608, 630. In the earlier case the court say: "If the executions can be levied upon one car, they can be levied upon all the cars upon the road. If they can be levied upon part of the fuel, they can be levied upon all of it, and thus the business of the road may be entirely suspended. Such a result would not only produce great injury to the plaintiff (the mortgagee), but great inconvenience to the public. It would prevent all travel upon the road, and effectually destroy its business and its usefulness. If the property was subject to execution, the plaintiff would have no right to complain, let the consequences be what they might; but, not being subject to execution, he has a clear right to apply to the chancellor for an injunction to prevent an act which might be productive of so great an injury; the right to redeem the property, being a right that belongs to the corporation, is liable for debts; but the defendants were not attempting to sell this equity of redemption, but the property itself, which they had no right to do."

[48] Elizabethtown &c. R. Co. v. Elizabethtown, 75 Ky. 233.

main line, found in Tennessee, were not subject to attachment, but were protected as subject to the lien of the mortgage.[49]

§ 144. **In New Jersey this question has been very fully discussed**, and the arguments upon the question—whether rolling stock is personal property or fixtures to the realty—most ably presented upon both sides in the different decisions rendered in the case of Williamson v. The New Jersey Southern Railroad Company.[50] The Lackawanna Iron and Coal Company recovered a judgment against this company in 1874, upon which execution was issued, and levies were made in every county of the state through which the road was extended, upon the cars, engines, and rolling stock of the company. In 1869 the company had executed a mortgage to Williamson, in trust, to secure bonds to the amount of $2,000,000. This deed covered all the railways, branches, rights of way, depots, station-houses, and the company's franchises then held or thereafter to be acquired, including its rolling stock, fixtures, tools, and machinery, and all real estate of every kind, and all personal property of every nature, then held or thereafter to be acquired. A covenant for further assurance provided that the company would hold all after-acquired franchises and property, real and personal, in trust for the mortgagee, and would make conveyance thereof accordingly from time to time, as the same might be acquired. This mortgage was duly recorded as a mortgage of real estate soon after it was executed and delivered, and long before this judgment was recovered; but it was not filed in compliance with the act concerning chattel mortgages. The chancellor, in an able opinion, held that the rolling stock mortgaged with a railroad is a part of the realty; or, if it be considered personalty, the provisions of the act concerning chattel mortgages had no application.[51]

§ 144a. **In Maryland** it has been held that no execution can be levied upon the property of a railroad company, which is essential for the performance of its corporate duties, unless such levy is

[49] Buck v. Memphis &c. R. Co. 4 Cent. L. J. 430. See § 70.

[50] 28 N. J. Eq. 277; 26 N. J. Eq. 398; and finally, in the Court of Errors and Appeals, March Term, 1878, 29 N. J. Eq. 311.

[51] Williamson v. New Jersey &c. R. Co. 28 N. J. Eq. 277.

authorized by statute. This doctrine is applicable only to quasi-public corporations and since the state has charged them with a duty towards the public, it is against its policy to allow such corporations to be so crippled that the duty cannot be performed.[52]

IV. *Rolling Stock regarded as Personal Property.*

§ 145. In the last-mentioned case the Court of Errors and Appeals reversed the chancellor's decision in regard to the nature of rolling stock, and established the rule in New Jersey that this kind of property must be regarded as personalty, and that a mortgage of it, to be valid, must conform to the provisions of the act relating to mortgages of property of that description.[53]

[52] McColgan v. Baltimore Belt R. Co. 85 Md. 519; 36 Atl. 1026; State v. Consolidation Co. 46 Md.; Brady v. Johnson, 75 Md. 445; 26 Atl. 49; 20 L. R. A. 737n.

[53] Williamson v. New Jersey &c. R. Co. 29 N. J. Eq. 311, 330. Mr. Justice Depue delivered the able and learned decision of the court, in the course of which he said: "The criterion of actual annexation to the freehold, as a rule for determining when chattels become part of the realty, is as well settled in this state as any other rule of property. Exemptions founded on fanciful and groundless distinctions only tend to produce uncertainty and confusion in the rules of property, which should be permanent and uniform. 'The general importance of the rule,' says Cowen, J., 'which goes upon corporeal annexation, is so great that more evil will result from frittering it away by exceptions than can arise from the hardships of adhering to it in particular cases.' Walker v. Sherman, 20 Wend. (N. Y.) 636, 656. Tested by the foregoing criterion, it is manifest that the rolling stock of a railroad must be regarded as chattels which have not lost their distinctive character as personalty by being affixed to and incorporated with the realty. It is true that engines and cars are adapted to move on the track of the railroad, and are necessary to transact the business for which the railroad was designed. But unattached machinery in a factory, the implements of husbandry on a farm, and furniture in a hotel, are similarly adapted for use in the factory, on the farm, or in the hotel, and are equally essential to the profitable prosecution of the business in which they are employed. When regard is had to the fundamental and necessary condition under which the law permits chattels to become part of the realty, engines and cars of the rolling stock of a railroad utterly fail to answer the requirements of the law. Cars

Pending this suit the State of New Jersey passed a statute in reference to the registration of mortgages given by certain corporations, providing that nothing in any of the laws of the state shall be held to require the filing of record of any mortgage given by any such corporation conveyed the franchises, and including chattels then or thereafter to be possessed and acquired, if such mortgage shall be duly lodged for registry as a conveyance of real estate.[54] But the court regarded the rights of the judgment creditor as fixed and vested in 1874, when the levy was made under the executions, which no subsequent legislation could take away. The Act of 1876 does not necessarily require a retrospective construction, and therefore the court would not allow it that effect; and, if the language used required such a construction, it could not be effective to deprive a party of prior vested rights acquired under the levy.

Another point made on the argument was that, even if the rolling stock be goods and chattels, and a mortgage thereof be required to be registered or filed by the Chattel Mortgage Act, the mortgagee having taken actual possession of such property before the judgment was recovered, the complainant's mortgage is entitled to priority over the judgment. The mortgage was made on September 14, 1869, and possession was not taken of the rolling stock by the mortgagee until January 1, 1874. The mortgage was not accompanied by an imme-

which left Jersey City this morning, before the close of the succeeding week will be found scattered over all the West, or on the Pacific coast,—their places of transportation through this state being supplied by cars gathered from the railroads of other companies, many of which are located in other states. The suggestion that each one of these cars carries with it the attributes of realty in its journey through other states, or even over other railroads in this state, will show the incongruity of denominating that a fixture which, in its ordinary use, travels over other railroads, and is connected with the railroad of its owner in no other way than in its useful employment in the business in which the company is engaged." See, also, McMillan v. Fish, 29 N. J. Eq. 610. In the earlier case of State Treasurer v. Somerville & Easton R. Co. 28 N. J. L. 21, rolling stock had been regarded as personal property, and not included under a statute taxing a "road with its appendages." Chief Justice Green declared that engines and cars are no more appendages of a railroad than wagons and carriages are appendages of a highway.

[54] Acts of 1876, p. 308, § 4.

diate delivery of the property mortgaged, but possession was taken before the judgment was recovered. But, while a subsequent purchaser or mortgagee, in order to avoid a prior mortgage for neglect to file the same, or to take possession, must have taken his title under the mortgagor in good faith, and without notice of the existence of the antecedent mortgage, a creditor may avoid it, although he has such notice. Consequently, possession taken of the mortgaged property under a prior chattel mortgage, however long postponed, will give it priority over a subsequent purchase or mortgage, if possession be taken in fact before such subsequent sale or mortgage was made. But a creditor is entitled to the benefit of the statute, whether his rights accrued before or after the mortgage; and, since his knowledge of the existence of the mortgage does not preclude him from availing himself of the objection that the mortgage is void, because it was not accompanied by immediate delivery of the things mortgaged, followed by an actual and continued change of possession, a subsequent taking possession by the mortgagee of the chattels mortgaged will not give validity to the mortgage as against such creditor. He is entitled to the benefit of the statute in all cases; and the mortgage is not valid against him unless it is filed according to the statute, or there was an immediate delivery and continued change of possession of the things mortgaged.[55]

§ 146. **In New York it has finally come to be the settled doctrine of the courts that the rolling stock of a railroad is personal property**, and not part of the realty, and that a mortgage is not effectual to give a lien upon such rolling stock as against creditors of the company unless it be recorded as a chattel mortgage, or is immediately delivered to the mortgagee. This question was first passed upon in this state in the year 1857, by the Supreme Court, which held that rolling stock is to be deemed constructively annexed to the road, and that a mortgage of a road and its equipment is effectual against judgment creditors without being filed as a personal property mortgage.[56] In the following year other justices of the same

[55] Williamson v. New Jersey &c. R. Co. 29 N. J. Eq. 311, per Depue, J., and see Stevens v. Buffalo &c. R. Co. 31 Barb. (N. Y.) 590; Thompson v. Van Vechten, 27 N. Y. 568.

[56] Farmers' &c. Co. v. Hendrickson, 25 Barb. (N. Y.) 484.

court held that rolling stock should be regarded as personalty, and that a mortgage of it was ineffectual unless it was filed under the act relating to mortgages of personal property.[57] This decision was followed in the year 1859 by another, rendered in the same court, which sustained the same view.[58] For several years there seems to have been a general acquiescence in these decisions. But in 1867 the matter was again brought in question in the Supreme Court, at special term, before Mr. Justice Sutherland, who, while holding that rolling stock does not become part of the realty, also held that a mortgage of the franchises and property of a railway, so far as the personal property covered by it is concerned, should not be deemed to be subject to the Chattel Mortgage Act.[59] At general term this decision was affirmed;[60] and Mr. Justice Ingraham, delivering the only opinion, declared that he was not prepared to accede to the opinion that rolling stock is in all cases to be considered as personal property, but that, when the intent of the parties is manifest that the rolling stock should pass as part of the realty, such a construction should be given to the transaction. He held that the Chattel Mortgage Act did not apply to a mortgage executed by a railroad company of its corporate property and franchises, for such a mortgage is intended, both by the legislature which authorized it and by the parties to it, to be treated as a mortgage of the road and its accessories. Upon appeal to the Court of Appeals, it was held that the rolling stock of a railway does not pass by a mortgage as part and parcel of the realty; and, also, that the law requires a mortgage of such property to be filed as a chattel mortgage when no change of possession takes place.[61]

[57] Stevens v. Buffalo &c. R. Co. 31 Barb. (N. Y.) 590.

[58] Beardsley v. Ontario Bank, 31 Barb. (N. Y.) 619.

[59] Bement v. Plattsburgh &c. R. Co. 47 Barb. (N. Y.) 104, 109.

[60] Hoyle v. Plattsburgh &c. R. Co. 51 Barb. (N. Y.) 45.

[61] Hoyle v. Plattsburgh &c. R. Co. 54 N. Y. 314; 7 Am. Ry. R. 283, 290. Upon the first point the court say: "Looking now at the rolling stock of a railroad, it is originally personal in its character; it is subservient to a mere personal trade, —the transportation of freight and passengers The track exists for the use of the cars, rather than the cars for the use of the track. There is no annexation, no immobility from weight; there is no localization in use. The only element on which an argument can be based to support the character of realty

In regard to the difficulties and embarrassments thus presented by the learned judge who delivered the opinion of the court, it may be remarked that, because rolling stock is considered to be a part of the realty as between the mortgagees and creditors claiming liens upon it as personal property, it is not necessary that it should be considered realty for the purpose of taxation; or that it should be considered realty in any other relation than that existing between the railroad company and those claiming under it on the one hand, and the mortgagees on the other. It is admitted this view is well adapted and accommodated to this relation, at least so far as the mortgagor and mortgagee are concerned. Because a railway track annexed to the realty by a mortgagor becomes part and parcel of it as to the mortgagee, it does not follow that if the track were built by a tenant for use in his trade, upon leased lands, that it would become a part of the realty as to him. The right of the mortgagee to hold it as realty in the one case, and the right of the tenant to remove it in the other, would be beyond question.

Upon the point whether a mortgage of rolling stock, when not considered a part of the realty, is within the statute relating to the filing of personal property mortgages, the court well say that, if this case is to be excepted, it must be either on account of the char-

is adaptation to use, with and upon the track. At the present time, independent companies exist owning no tracks, whose trains run through state after state on the railroad tracks of other companies. It is no uncommon sight to see the cars of half a dozen companies formed into a single train, and running from New York to Illinois and Missouri. It is impossible to deal with such property as part of the realty without introducing anomalies and uncertainties of the gravest character. Call cars and engines part of the realty,—where shall they be taxed? Real estate is to be taxed at its site. What is the site of a railroad train running from New York to Buffalo in a day? Shall it be taxed in each town where the assessors catch sight of its rushing by at thirty miles an hour? Or, if a judgment be docketed in one county on the line, will its lien attach on each car as it whirled past?" In Randall v. Elwell, 52 N. Y. 521; 11 Am. R. 747, it is decided that rolling stock is personal property, and, as such, is liable to be seized and sold for taxes.

To recur to the old example,—doves in a dove-cote are constructively annexed to the realty. But do they not fly through the air at the rate of thirty miles an hour, and temporarily leave the real estate to which they are annexed?

acter of the mortgage or of the property mortgaged, or on account of some provision of the statute law taking away the necessity of filing.[62]

Whether such a mortgage is to be filed only in the town in which the corporation has its principal place of business, or in every town through which the line of the road passes, is a question which the court, in this case, do not decide—the law requiring the filing of the mortgage in the town where the mortgagor resides, or where the property mortgaged is at the time. For many purposes, they say, a corporation is to be deemed resident where its place of business or chief office is situated, and at most it could only be deemed resident in all the towns in which any part of its line is located. But, as elsewhere noticed, the recording of mortgages of rolling stock is now regulated by statute.

§ 147. In Ohio rolling stock is regarded as personal property. In one case[63] the court drew a broad line of distinction between the

[62] "A railroad corporation does not differ from any other corporation, nor from any natural person, in respect to the general obligation to obey the laws. It is just as likely to get fraudulent credit as any other corporation, and can claim no special immunity. No distinction can be drawn to exclude a railroad corporation from the provisions of this statute which would not equally exclude every trading corporation. . . . In respect to the character of the property mortgaged, no exemption from obedience to the law can be sustained. A railroad and rolling stock may be owned by a private individual by purchase, or may be constructed by a private individual on his own land, and he may take fare for its use such as he pleases to charge; unless he wants the public power of eminent domain, or the use of public property or easements, he has no occasion to consult anything but his own will and his own purse about constructing or running a railroad. The character of the property itself cannot, therefore, furnish any exemption from obedience to the law." Per Johnson, in Hoyle v. Plattsburgh &c. R. Co. 54 N. Y. 314, 326, 327; 13 Am. R. 595.

[63] Coe v. Columbus &c. R. Co. 10 Ohio St. 372, 379; 75 Am. R. 518. "The distinction," says Mr. Justice Gholson, "appears to us to be as plain as that between a farm and the implements and stock which the proper use of the farm necessarily requires. There are instances which may be put still more analogous. Take, for example, a ferry franchise. It is connected with real estate; it is itself an incorporeal hereditament, and

real and personal property of a railway company, including in the former the road as constructed and prepared for use, with its fixtures of timber and iron for the track, of stone and timber for bridges and culverts, its depots and structures for supplying water; and in the latter those things requisite for operating the road—locomotives, cars, and other articles and materials, some of which are consumed in the use, and require to be renewed from time to time. The line is broadly drawn between the interest in real estate and the franchises connected therewith, and the movable things employed in the use of the franchise.

§ 148. In New Hampshire[64] the rolling stock of railroads, like

therefore, real estate. The use of this franchise requires boats and other movable appliances. But these, when employed in the use of the ferry franchise, do not thereby become a part of the real estate; they are the personal property of the owner of the ferry franchise,—or, it may be, of some person to whom the ferry franchise has been demised for a term of years. Considerations of public policy and convenience have been pressed upon our attention in connection with the question under examination. It may be true that a railroad corporation holds its property, in a certain sense, as a public trust,—to answer the purpose of a public highway, the transportation of persons and property. But it is consistent with that public trust to contract obligations. Indeed, the very exercise of the trust necessarily involves obligations to individuals; and, to meet those obligations, the property of the corporation must in some form be liable. The question is, In what form? Shall it be in the ordinary legal form applicable to the property of individuals, or shall peculiar rules be introduced, which may have the effect to delay creditors, and operate as a shield to protect property from their just demands?" In conclusion, the court say that the interest of the owners of the road must be the reliance for its continued operation; that it is not the policy of the state, nor would it be just to individuals, that the power of the court should be invoked to enable an insolvent corporation to operate a railroad by protecting its property from the claims of creditors,—those, it may be, who have performed for it labor, or have suffered losses, or sustained injuries, by the misconduct of its agents.

[64] Boston &c. R. Co. v. Gilmore, 37 N. H. 410, 423; 72 Am. Dec. 336. "Considering, then, that it is not necessary for the discharge of the public duties of railroad corporations that they should be the owners of cars or engines, many such roads being operated with the cars of other corporations; that it is a matter of great uncertainty what

other personal property, is held liable to attachment and levy when not in actual use. It was argued by counsel for a railroad company whose property was attached that, such property being necessary to enable the corporation to discharge its public duties, it vested in the corporation in trust for the public; that the franchise of the corporation is the principal thing, to which the track, depots, engines, cars, and the like are mere incidents, and that all these constitute one entire thing, so connected that the cars and engines cannot be severed from their connection by an attachment or seizure on execution, and held as security, or sold and applied as personal property ordinarily may be, for the payment of the corporate debts. But the court say the idea that property, either real or personal, may become a mere incident to a franchise, so that the franchise and property shall constitute an entire thing, is not found in any of the books of the common law. A ferry is mentioned as an instance of a franchise, for the use of which, and for the discharge of its public duties in the transportation of passengers and goods, its boats are wholly indispensable; yet no case is found where it has been claimed that such boats are exempt from seizure in discharge of the owner's debts.

§ 149. **In Massachusetts** it has been held that, under a mortgage of a railroad, its locomotives and cars, together "with all improvements made upon such property, and all additions thereto, by adding new locomotives, cars, and other things," cars subsequently purchased by the corporation are included, although the mortgagees

articles of the personal property of such corporations are necessary for the discharge of their public duties; that no means exist by which it can be determined what is necessary or otherwise; that it must be very difficult for courts to lay down any definite rule by which officers can be guided, who, in all such cases, must decide at their peril,—it seems to be neither judicious nor expedient to establish an exemption of this kind, unless it is done by the direct action of the legislature, who can provide the proper rules and safeguards for the safety of officers as well as of parties." In the earlier case of Pierce v. Emery, 32 N. H. 484, the Supreme Court of this state had held that there was nothing in the nature of the business of a railroad company, or in its relations to the public, which prevented it from making a valid mortgage of its personal property not affixed to the road, though used in operating it. See § 96.

had not taken possession for foreclosure; but the decision was based in part upon the fact that the mortgage was confirmed and ratified by legislative act, and thus effect was given to all parts of it, including the provision as to after-acquired machinery and cars. This mortgage was duly recorded, and thus, say the court, by means of the record and the statute, the lien thereby created was duly notified to all persons having dealings with the corporation; and therefore a creditor of the corporation could not make a valid attachment of cars subsequently purchased.[65]

§ 150. In conclusion upon this part of the subject, it may be said that, while there are many and strong arguments for holding that rolling stock is part of the realty—and this view seems to have the support of the United States courts—the weight of authority in the state courts seems to be against that position. There is, however, no hope that any uniform and settled rule upon this subject will soon be arrived at by the courts without the aid of legislative enactments. It is of the highest importance that the validity of mortgages intended to embrace the rolling stock and other personal property of a railroad should not be left to the uncertain decision of the courts; for in the present state of the law, it must at least be regarded as uncertain how the question would be determined by any court not bound by a precedent or by statute.

V. *Constitutional and Statutory Provisions regarding Rolling Stock.*

§ 151. In several states there is now a constitutional provision "that rolling stock and all other movable property belonging to any railroad company or corporation shall be considered personal property, and shall be liable to execution and sale in the same manner as personal property of individuals, and the general assembly shall pass no law exempting any such property from execution and sale." This provision was first made a part of the fundamental law of Illinois[66] in 1870, where the courts had previously declared rolling stock

[65] Howe v. Freeman, 80; Mass. 566.

[66] Const. 1870. art xi. § 10. R. S. 1905.

to be fixtures. This provision has since then been adopted in the same words in Missouri,[67] Arkansas,[68] Nebraska,[69] Texas,[70] Utah,[70a] and West Virginia.[71]

The general purpose of this constitutional provision is, undoubtedly, to enable general creditors of railroad corporations, whose claims may be small, to find property out of which their claims may be satisfied. When the franchise and property of a railway company, and perhaps its tolls as well, are all covered by mortgage, the general creditors are practically left without remedy against it; for, even if there be any value in the property above the mortgage, it is extremely difficult for a general creditor to reach and apply the surplus to the payment of his claim, while the expenses of the proceedings for this purpose are very large.

This provision, however, would not prevent the mortgaging of rolling stock as personal property; and a railroad mortgage recorded in accordance with the law regulating the recording of chattel mortgages would effectually cover such property. Moreover, as already noticed, this provision does not change the rule that a mortgage may be made to cover after-acquired rolling stock.[72]

As already intimated, it seems to be a matter of the highest importance to mortgage bondholders that the different states should, by statute, make it certain where a mortgage of a railroad, including its equipment, should be recorded in order to make the lien effectual as to the rolling stock and other like property. In those states in which the law requires that mortgages of personalty shall be filed for record in the office of the clerk of the city or town in which the mortgagor resides, it may be sufficient to record a railroad mortgage only in the city or town where the railroad corporation has its principal office or place of business.[73] That, for most

[67] Const. 1875, art. xii. § 16. R. S. 1899.

[68] Const. 1874, art. xvii. § 11. Digest of Stats. 1894.

[69] Const. 1875, art. xi. § 2. Comp. Stats. 1905.

[70] Const. 1876, art. x. § 4. Annot. Const. (Axtell) 1901; R. S. 1895. See, also, General Railroad Act 1876, ch. 97, § 24.

[70a] Const. art. xiv, § 14; R. S. 1898.

[71] Const. 1872, Annot. Code 1906; art. xi. § 8.

[72] Scott v. Clinton &c. R. Co. 6 Biss. (U. S.) 529.

[73] So provided by statute in Maine. Rev. Stat. 1871, ch. 91, § 1; R. S. 1903, ch. 93, § 1. Also in Indiana. Burns Annot. Stats. 1901,

purposes, is regarded as the place of residence of the corporation.[74] It would be an extreme inconvenience to the mortgagee, and a source of great danger of loss, if he is in such cases required to record his mortgage in several hundred towns, it may be, through which the mortgaged road may pass. The supposition that a railroad corporation is a resident of the place where its principal office is located, rather than a resident of all the towns through which its line of road passes, has been acted upon frequently in the matter of recording railroad mortgages; but without positive legislation upon the subject, or legal decision of this point, there is just enough uncertainty about it to make the position of a mortgagee, who looks to the rolling stock and other personal property embraced in his mortgage as a material part of the security, quite uncomfortable. The legislation that is demanded upon this subject is that which has been adopted in several states, namely, the making of the record required for the protection of the real estate included in the mortgage effectual also as a record of the personal.

Of course, when a subsequent incumbrancer has actual notice of a prior mortgage, and of the fact that its terms embrace rolling stock, he cannot object that it was not filed as a chattel mortgage, because the notice is equivalent to such filing.[75]

§ 152. In California[76] locomotives, engines, and other rolling stock of a railroad are enumerated among the articles of personal property of which a mortgage may be made. But mortgages of personal property are recorded in the office of the county recorder, in which mortgages of real property are also recorded; only they must be recorded in books kept for personal mortgages exclusively, and must be recorded in the county in which the mortgagor resides, and also in that in which the property is situated, or to which it

vol. 3, § 6638; Androscoggin & Kennebec R. Co. v. Stevens, 28 Me. 434.

[74] As generally, for taxation, the place of business of the corporation is considered the situs of its personalty. Cooley Tax. 273, and cases cited; Dubuque v. Illinois Central R. Co. 39 Iowa, 56; Missouri v. Severance, 55 Mo. 378; Pacific R. Co. v. Cass County, 53 Mo. 17; Dillon Munic. Corp. § 629.

[75] Benjamin v. Elmira &c. R. Co. 54 N. Y. 675.

[76] Civil Code, §§ 2955, 2959, 2961; Supp. Codes 1905; § 2955; Bishop v. McKillican, 124 Cal. 321; 71 A. S. R. 68.

may be removed. Personal property used in conducting the business of a common carrier is to be taken as situated in the county in which the principal office or place of business of the carrier is located.

§ 153. **In Connecticut**[77] it is provided by statute that, whenever any railroad company has mortgaged its railroad, pursuant to law, to secure its bonds, and has included in said mortgage all or any part of its rolling stock, locomotives, and cars, whether those owned by it at the date of said mortgage or those thereafter to be acquired by it for use upon said railroad, or both, such mortgage shall be deemed valid and effectual as respects all the property therein included as aforesaid, and may be foreclosed in the same manner as ordinary mortgages of real estate; and the record thereof in the office of the secretary of state shall be a sufficient record and notice to protect the title under the mortgage, notwithstanding such company may remain in possession of all or any part of the mortgaged property.

§ 154. **In Dakota, North**[78] **and South,**[79] all rolling stock of any railroad corporation used and employed in connection with its railroad, and all fuel necessary to the operation of the same, are declared to be fixtures.

§ 155. **In Florida** the general railroad law of 1874, for the incorporation of railroads and canals, provides that a railroad company may make such provisions in any trust deed or mortgage for transferring the railroad, the rolling stock, and other furniture and appurtenances in connection therewith, or which shall thereafter belong to it, as security for any bonds, debts, or sums of money secured, as the company may deem proper. Such trust deed or mortgage may, by the direction of the board of directors of such company, be recorded in the office of the secretary of state, in a book

[77] Public Acts 1877, ch. 38; G. S. 1888, § 3572; G. S. 1902, § 3806. Such a mortgage executed in accordance with the laws of Connecticut is valid in New York as against an attachment of rolling stock made there, though the mortgage is not recorded as required by the laws of the latter state. Nichols v. Mase, 94 N. Y. 160.

[78] R. Code 1895, § 2957.

[79] Annot. Stats. 1901, § 3910.

kept for that purpose; and when so recorded, it is evidence and notice to all persons of its existence and lawful execution, without its being recorded elsewhere in the state; and when so recorded it has the same effect as if recorded in the several counties through which the road may be built, and is notice to the same extent and effect as if so recorded. All rolling stock used in connection with a railroad is declared to be fixtures, and is subject to the lien of any mortgage of the road.[80]

§ 156. **In Iowa**[81] it is provided that any mortgage of the real and personal property of a railroad company, whether then owned by it or afterwards acquired, when duly executed and recorded in the office of the recorder of each county through which the railway of the corporation may run, or in which any property mortgaged may be situated, shall be notice to all the world of the rights of all parties under the same; and for this purpose, to secure the rights of mortgagees or parties interested under deeds of trust so executed and recorded, the rolling stock and personal property of the company properly belonging to the road, and appertaining thereto, shall be deemed a part of the road, and such mortgages and deeds so recorded shall have the same effect, both as to notice and otherwise, as to the personalty, that they have upon the real estate conveyed by them.

§ 157. **In Massachusetts**[82] it is provided that any railroad company may issue bonds for any lawful purpose, and may mortgage or pledge as security for the payment of such bonds any part or all of its road, equipment, or franchise, or any part or all of its property, real or personal, then owned or thereafter acquired.

It is provided that cars and engines in use upon railroads shall not be attached upon mesne process in any suit within forty-eight hours previous to their fixed time of departure, unless the officer shall

[80] Acts of 1874, ch. 1987, § 9, par. 10, and § 31; Dig. of Laws 1881, pp. 279, 280, 286; G. Stats. 1906, § 2806.

[81] R. Code 1880, §§ 1284, 1285; Annot. Code 1897, § 2043. Yet the rolling stock seems to be regarded as personal property. Dubuque v. Illinois Central R. Co. 39 Iowa, 56, 86, per Beck, J.

[82] P. S. 1882, ch. 112, §§ 62, 72; Acts 1874, ch. 372, § 49; 1875, ch. 58; Acts 1906, ch. 463, pt. I, § 48.

have first demanded other property equal in value to the *ad damnum* in the writ upon which to make such attachment, and such demand has been refused or neglected.[83]

§ 158. **In Minnesota,**[84] by a statute enacted in 1868, mortgages or deeds of trust of railroad companies may, by their terms, include and cover, not only the property of the companies making them at the time of their date, but property, both real and personal, which may thereafter be acquired by them, and they are as valid and effectual for that purpose as if the property were in possession at the time of the execution thereof. Such mortgages or deeds of trust, recorded in the office of the register of deeds of each county through which the road mortgaged or deeded may run, or wherever it may hold lands, will be notice to all the world of the rights of all parties under the same; and for this purpose, and to secure the rights of mortgagees or parties interested under deeds of trust so executed and recorded, the rolling stock and personal property of the company properly belonging to the road and appertaining thereto are deemed a part of the road, and such mortgages and deeds so recorded

[83] Act 1875, ch. 144, § 1; Acts 1906, ch. 463, pt. I, § 61; Cox v. Central &c. R. Co. 187 Mass. 596, 73 N. E. 885.

[84] G. S. 1878, ch. 34, §§ 72, 73; Act March 5, 1868. As to record in the office of the secretary of state having same effect, see Act March 6, 1867; 1 Stat. at Large, 430.

It is evident that the section above quoted means something more than merely to provide what shall be notice of the mortgagee's rights. The provision that the rolling stock and personal property, properly belonging to the road, shall be deemed a part of the road, must have been inserted for the purpose of securing the rights of mortgagees. Assuming that at common law, movable property of a railroad is subject to levy and sale, a provision that "movable property shall be a part of the road" changes this rule and makes the road with its rolling stock one property like the different parts constituting one machine, and inseverable. Giving this meaning to the section, it adds to the mortgagees' security, which would be precarious if each item of movable property is liable to be levied on and sold. To prevent this was the purpose of the clause making the property part of the road. Unsecured creditors can still levy on any real estate not part of the road or upon any personal property not rolling stock. Central Trust Co. v. Moran, 56 Minn. 188; 57 N. W. 471; 29 R. L. A. 212.

have the same effect, both as to notice and otherwise, as to the personalty, as upon the real estate covered by them.

§ 159. **In Montana**[85] it is provided that any railroad corporation may mortgage its property and income; and, if the mortgage shall so provide, it shall be and remain a valid lien upon all of the property of the company of whatever kind then existing, or that may thereafter be by it acquired, irrespective of the law now in force relating to chattel mortgages, and the same shall be taken, held, and enforced in the same manner as mortgages upon real estate now are held and enforced.

§ 160. **In Nebraska**[86] the general railroad law provides that mortgages and deeds of trust of railroad companies shall be recorded in the office of the county clerk of each organized county through which the mortgaged road may run, or in which it holds lands, and shall be notice to all the world of the rights of all parties under the same; and for this purpose, and to secure the rights of mortgagees or parties interested under deeds of trust, the rolling stock, personal property, and material necessary for repairing the road of the company, belonging to said road, or appertaining thereto, shall be deemed a part of the road; and such mortgages and deeds of trust so recorded shall have the same effect, both as to notice and otherwise, as to the real estate covered by them.

§ 161. **In New Jersey**[87] a law passed in 1876 provided that noth-

[85] Laws 1873, p. 102; Compiled Statutes, § 1555. This act is intended to enable corporations owning property of a mixed character, both real and personal, to mortgage the same in one instrument, which is governed by the law relating to real estate. As to the personal property included, such instrument is not subject to the limited duration of a strictly chattel mortgage. The act relates to mortgages where no actual change of possession accompanies the transaction, and is not intended to apply to transfers where actual delivery of possession accompanies the transaction. Teitig v. Boesman Bros. & Co. 12 Mont. 404; 31 Pac. 371.

[86] G. S. 1873, ch. 11, § 120. See Comp. Stats. 1905, ch. 16, §§ 117, 118, 119.

[87] Laws 1876, p. 308, § 4; 2 Rev. 1877, p. 924, § 82; Gen'l Stats. 1895, vol. 2, p. 2684, § 4. This statute does not apply to mortgages executed before its passage. Boylan v. Kelly, 36 N. J. Eq., overruling Kelly

ing in any of the laws of the state shall be held to require the filing of record in the clerk's office of any county of any mortgage given by any such corporation, conveying the franchises thereof, and whereby, also, any chattels then or thereafter to be possessed and acquired by such corporation shall purport to be mortgaged; provided, that such mortgage shall be duly lodged for registry according to the laws regulating the conveyance of real estate.

§ 162. **In New York**[88] it was, in 1868, provided that it shall not be necessary to file as a chattel mortgage any mortgage which has been, or may be, executed by any railroad company upon its real and personal property, and which has been, or shall be, recorded as a mortgage of real estate in each county in or through which the railroad runs.

§ 163. **In Ohio**[89] it is provided that in all cases where a mortgage has been, or may hereafter be, executed upon any portion of the personal and real property of any railroad company within the state, by proper officers, to secure the payment of any loans of money, or advances of material or labor made to said company, it shall be a sufficient record of the same to have the same recorded in the office of the recorder of deeds in each of the counties in which said real or personal property may be situated or employed, and said mortgage so recorded shall be held to be a good and substantial lien from the date of the record of the same in each county where the same

v. Boylan, 32 N. J. Eq. 581. It applies to mortgages by horse railroad companies. Kelly v. Boylan, 32 N. J. Eq. 581. But the statute does not apply as against a levy of an execution made prior to the passage of the act, for in that case the plaintiff in the execution has obtained a vested right. Williamson v. New Jersey &c. R. Co. 29 N. J. Eq. 311. This statute is not repealed or affected by the subsequent chattel mortgage acts. Laws 1878, pp. 139, 347; Laws 1880, p. 266; Laws 1881, p. 226; Gen'l Stats. 1895, vol. 2, p. 2114, §§ 9–10; Metropolitan Trust Co. v. Pennsylvania &c. R. Co. 25 Fed. 760.

[88] Laws 1868, ch. 779, § 1; 2 R. S. 1875, p. 555, § 115; R. S. 1889, p. 1783; Laws 1897, ch. 676; White Corps. 1905, § 91; Platt v. New York &c. R. Co. 9 App. Div. (N. Y.) 87; 41 N. Y. S. 42; affirmed in 17 Misc. (N. Y.) 22; 39 N. Y. S. 871.

[89] 1 R. S. 1860, p. 322, passed Feb. 9, 1853; Bates Annot. Stats. 1906, vol. 2, §§ 3287–3289.

is recorded, as well upon the personal as the real property of said company.

§ 164. **In Utah**[90] the rolling stock, machinery, personal property, and material necessary for the operation and repairs of a railroad, belonging and appertaining thereto, are deemed fixtures on and a part of the road; and mortgages or trust deeds recorded in each county through which such road may run, or in which it may hold lands, have the same effect, both as to notice and otherwise, as they have in respect to the real estate covered by them, though the possession of such property remains with the mortgagors.

§ 165. **In Vermont**[91] mortgages of railroad franchises, furniture, cars, engines, and rolling stock, when properly executed and recorded, vest in the mortgagee a mortgage interest in, and lien upon, such property, without delivery or change of possession; and, for the purpose of mortgage, all such property is deemed part of the realty. Such a mortgage is recorded in the office of the county clerk of each county through which the road passes, instead of the offices of the town clerks; and when so recorded, it has the same effect as if recorded in the several offices of the town clerks of the towns through which such road passes. It is provided, however, that such rolling stock may be attached by any person having a claim against the company for an injury sustained on the road by reason of any neglect of the corporation, or for services rendered or materials furnished for the purpose of keeping the road in repair or in running the same, or for any liabilities as common carriers, or for the loss of any property while in the possession of the corporation.

§ 166. **In West Virginia**[92] the rolling stock, and all other movable property belonging to any railroad company, are considered personal property, and are liable to execution and sale in the same manner as the personal property of individuals. Mortgages, however,

[90] 2 Comp. Laws 1882, § 2371; R. S. 1898, § 444.

[91] G. S. 1870, ch. 28, §§ 100–102; Acts 1851, No. 57, § 1, and 1856, No. 29, §§ 1, 2; R. L. 1880, §§ 3352, 8353; Stats. 1894 §§ 3800–3803.

[92] Act April 3, 1873; ch. 88 of Acts 1872–1873; Code 1906, ch. 54 § 2344.

of real property and mortgages of personal property are recorded in the same county registry and under the same laws.[93]

§ 167. **The general railroad laws of Wisconsin**[94] provide that railway companies may, in mortgages or trust deeds, make such provisions for pledging or transferring their property, including rolling stock and appurtenances in connection with the railroads, or which shall thereafter belong to them, as security for any bonds, debts, or sums of money secured, as such companies may think proper. Any deed of trust or mortgage of any locomotives, tenders, cars, or other property used or intended to be used as rolling stock or equipment on any railroad, and any discharge thereof acknowledged in such manner as would entitle a deed of real estate to be recorded, is sufficiently recorded or filed by filing a copy in the office of the secretary of state, and a certificate of such filing indorsed thereon by the secretary of state is evidence thereof; and such deed of trust or mortgage is valid and effectual as against the creditors of the company, or subsequent purchasers or mortgagees in good faith, without any further proceeding whatsoever. All rolling stock used in connection with a railroad is declared to be fixtures, and is subject to the same lien as is created by such trust deed or mortgage upon the real property of such railroad company; and every such deed of trust or mortgage recorded in the office of the secretary of state, in a proper book kept for the purpose, has the same effect as if recorded in the several counties through the road may be built; and such record is notice of the lien to all persons interested. But this statute makes rolling stock a fixture only for the purpose of enabling railroad corporations the more readily to give valid liens and mortgages upon their property. It does not contemplate that, in respect to all the legal remedies of parties, a car or locomotive should be treated as real estate; and it is accordingly held that such property is liable to seizure and sale for delinquent taxes as personal property.[95]

[93] Code 1870, p. 74, §§ 5, 7; Code 1887, ch. 54, § 51; Code 1906, ch. 54, § 2343.

[94] 2 Comp. Laws 1882, § 2371; Annot. Stats. 1898, vol. 1, ch. 87, §§ 1828, 1838, 1839.

[95] G. S. 1870, ch. 28, §§ 100–102; Acts 1851, No. 57, § 1, and 1856, No. 299, §§ 1, 2; R. L. 1880, §§ 3352, 3353; Peirce v. Milwaukee &c. R. Co. 24 Wis. 551; 1 Am. R. 203.

§ 168. **In Great Britain the rolling stock and personal property essential to the operating of railways are by statute protected from levy** by execution.[96] The act provides that the engines, tenders, carriages, trucks, machinery, tools, fittings, materials, and effects constituting the rolling stock and plant used or provided by a company for the purposes of the traffic on their railway, or of their stations or workshops, shall not, after their railway or any part thereof is open for public traffic, be liable to be taken in execution at law or equity; but the person who has recovered any such judgment may obtain the appointment of a receiver, and, if necessary, of a manager, of the undertaking of the company, on application by petition in a summary way to the Court of Chancery; and all money received by such receiver or manager shall, after due provision for the working expenses of the railway and other proper outgoings in respect of the undertaking, be applied and distributed, under the direction of the court, in payment of the debts of the company, and otherwise, according to the rights and priorities of the persons for the time being interested therein; and on the payment of the amount due to every such judgment creditor as aforesaid the court may, if it think fit, discharge such receiver, or such receiver and manager.

If in any case where property of a company has been taken in execution a question arises whether or not it is liable to be so taken, notwithstanding this act the same may be heard and determined on an application by either party, by summons in a summary way to the court out of which the execution issued, and such determination is final and binding.

It is also provided that companies unable to meet their engagements may file a "scheme of arrangement" in chancery, which, when assented to by a certain proportion of the mortgagees and shareholders, and confirmed by the court, is binding and effectual, and has like effect as if it had been enacted by parliament.

Prior to the passing of this act, it was held that the mortgagee of an undertaking could not have an injunction against judgment creditors who were about to take under an *elegit* the lands of the

[96] The Railway Companies' Act 1867, 30 and 31 Vict. ch. 127; and see 30 and 31 Vict. ch. 126, as to Scotland. These acts made perpetual in 1875, 38 and 39, Vict. ch. 31; and see 35 and 36 Vict. ch. 50; 10 Chitty's Stats. (Lely).

company;[97] for a mortgage of the undertaking does not ordinarily, and unless the intention is apparent by the deed, pass the land itself, or constitute any charge upon it.[98]

[97] Perkins v. Deptford Pier Co. 13 Sim. 277.

[98] Wickham v. New Bruswick &c. R. Co. L. R. I. P. C. 64; and see Hart v. Eastern Union R. Co. 7 Exch. 246, 265; Eastern Union R. Co. v. Hart, 8 Exch. 116; Perkins v. Pritchard, 3 R. & Can. Cas. 95. In Lower Canada, the rolling stock of a railway is held to be a part of the realty, and as such not liable to seizure under a writ of execution de bonis. Grand Trunk R. Co. v. Eastern Townships Bank, 10 Lower Can. Jur. 11

CHAPTER VI.

MORTGAGE BONDS OF CORPORATIONS.

I. *Formalties in making and issuing Bonds.*

I. Formalities in making and issuing bonds, §§ 169–183.
II. Negotiability of corporate bonds, §§ 184–210.
III. Incomplete and altered bonds, §§ 211–216.
IV. Remedies upon corporate bonds, §§ 217–223.

§ 169. The debt secured is usually in the form of negotiable bonds; but of course the debt may be in the form of a note or other obligation of the corporation, or its contract for any legitimate purpose. Thus a corporation may make a valid mortgage to secure the performance of an undertaking to pay dividends or interest on preferred stock issued and sold by the corporation, and ultimately to pay for or to retire such stock itself.[1]

§ 170. An ordinary money bond is an instrument under seal which contains an acknowledgment of the loan, and an agreement to repay the same upon the terms stated. Annexed to it, and forming a part of the bond originally, they are usually interest coupons or warrants for each instalment of interest accruing during the time the bond has to run. An ordinary bond does not itself create any charge or lien upon the property of the company, or give the holder any priority over any other creditor; but such a bond is usually secured by a mortgage or deed of trust, which creates a charge, and

[1] Fitch v. Wetherbee, 110 Ill. 475.

gives all the holders of the bonds secured a priority over all who may subsequently become creditors of the company. There are other bonds, not secured by mortgage, which are a charge upon property by force of statutes. Of these something has already been said.[2]

A bond may also by agreement be made a lien without a mortgage. Preferred stock issued under agreement that interest shall be paid upon it, and that it shall be a lien taking precedence of any subsequent indebtedness, though not secured by mortgage, creates a lien as between the parties. It also has priority as against subsequent mortgagees having notice of the agreement under which it was issued.[3] There are other bonds which are wholly unsecured; and of these and like securities something will be said in a subsequent chapter.[4]

§ 171. A bond implies a seal. A corporate seal may consist merely of an impression of a seal of the corporation, indented or stamped into the substance of the paper of a printed bond, without the use of wax, wafer, or other adhesive substance.[5] A corporate seal so impressed by the printer, by direction of the officers of the corporation, who adopt his act by signing and issuing the bond so prepared, makes the instrument valid as the bond of the corporation. In states where the distinction between sealed and unsealed instruments is inflexibly preserved, such a sealing is unquestionably valid; but in such states a *fac-simile* of the corporate seal printed with ink on the paper is not a valid seal. There is no definition of a seal, and none can be given, which would make this a seal. The printed form of a seal is nothing more than a scroll, and to adopt it as a seal would be to do away with the distinction between a sealed and an unsealed instrument.[6]

A sealed instrument conclusively imports a consideration; consequently, it is no defense to an action at law upon the bonds of a railroad company that their delivery by the company was merely

[2] See §§ 32–44.

[3] Atlantic &c. R. Co. In re 3 Hughes (U. S.) 320.

[4] See Chapter vii.

[5] Royal Bank of Liverpool v. Grand Junction R. &c. Co. 100 Mass. 444; Hendee v. Pinkerton, 66 Mass. 381; Allen v. Sullivan R. Co. 32 N. H. 446; Chilton v. People, 66 Ill. 501; Jones Mortgages, § 128.

[6] Bates v. Boston &c. R. Co. 92 Mass. 251.

gratuitous, and without the payment of value for them; or that the company delivered them as collateral security for the payment of other bonds. The corporation can avail itself of the fact that the bonds are held as collateral only by paying in full the amount of its real indebtedness.[7]

A corporate seal affixed to an instrument is also *prima facie* evidence that it was placed there by proper authority; or, in other words, that the instrument is the act of the corporation.[8]

The fact that such an instrument is issued under the seal of the corporation is now regarded as of no consequence in respect to its negotiability. This formality signifies that the corporation has duly executed the instrument. A seal does not make such an instrument a deed, or render it necessary that a transfer of it should be by a sealed instrument; but the holder may transfer it by the customary parol transfer, just as if it belonged to the class of simple contracts.[9]

§ 172. Corporations generally impose upon their officers certain formalities in the preparation and issue of their bonds or other evidences of debt, and it becomes an important inquiry how far these directions are binding upon persons who purchase bonds issued in disregard of such requirements. In general, it may be said that whenever the obligations issued purport to be the obligations of the corporation, and are so in fact, the omission of any preliminaries required by the articles of association, or by the by-laws of the corporation, cannot affect a *bona fide* purchaser without notice. Ordinarily the purchaser has no means of knowing what formalities are required as between the corporation and its officers, and no means of knowing whether such requirements have been fulfilled. A director or other officer of the corporation standing in such relation to the affairs of the corporation that he would be presumed to know both what the requirements are and whether they have been observed, could not, of course, take the obligations of the corporation, with all the rights of a third person purchasing without notice. Neither

[7] Royal Bank v. Grand Junction R. &c. Co. 100 Mass. 381.

[8] Memphis v. Adams, 56 Tenn. 518; 24 Am. R. 331; Levering v. Mayor, 7 Humph. (Tenn.) 553.

[9] Goodwin v. Robarts, L. R. 10 Ex. 337; General Estates Co. In re, L. R. 3 Ch. 758; Imperial Land Co. of Marseilles, In re, L. R. 11 Eq. 478.

ould a trustee corporation in the deed of trust take the bonds as a *bona fide* purchaser, for it is charged with knowledge of all the requirements for a legal issue of the bonds.[10] But a purchaser of a negotiable obligation from such officer or trustee for value, unacquainted with the circumstances under which it was originally issued, would have all the rights of a *bona fide* purchaser.[11]

Again, while a purchaser of a corporate security is bound to know whether the corporation had power to issue it at all, yet, when such authority depends upon a statute, a requirement as to the manner of exercising the power, as, for instance, that a vote of the stockholders or a resolution of the directors shall first be passed, may be presumed to have been complied with. "Third parties dealing with a corporation are bound to know the law; that is, they are bound to take notice of the extent of its powers, but they have a right to assume, in the absence of anything suggesting inquiry, that it has proceeded regularly in the execution of its powers."[12] A requirement of statute that the act of a corporation in issuing its obligations shall be authorized or ratified by a vote of its stockholders, is a requirement for their protection, and relates to the mode and manner of executing the power rather than to the existence of the power; and the purchaser has the right to presume that the corporation has done its duty and proceeded regularly in the execution of its power.

§ 173. Formality of a stockholder's vote.—In a leading English case upon this subject,[13] it appeared that the directors of a joint stock company were authorized by the deed of settlement to borrow such sums of money, within a certain limit, as the company should

[10] Buffalo &c. Co. v. Medina Gas Co. 162 N. Y. 67; 56 N. E. 505.

[11] Webb v. Herne Bay, L. R. 5 Q. B. 642; Singer v. St. Louis &c. R. Co. 6 Mo. App. 427; Hackensack Water Co. v. DeKay, 36 N. J. Eq. 548.

[12] Connecticut &c. Ins. Co. v. Cleveland &c. R. Co. 41 Barb. (N. Y.) 9.

[13] Royal British Bank v. Turquand, 6 E. & B. 327; 5 E. & B. 248. See, also, Colonial Bank v. Willan, L. R. 5 P. C. 417; Agar v. Athenaeum Life Ass. Co. 3 C. B. N. S. 725; Lowe v. London &c. R. Co. 18 Q. B. 632; London & N. W. R. Co. v. M'Michael, 5 Ex. 855; Prince of Wales L. Ass. Co. v. Harding, El., Bl. & El. 183; Pickard v. Sears, 6 Ad. & El. 469; Freeman v. Cooke, 2 Ex. 654, 663; Eastern Counties R. Co. v. Hawkes, 5 H. L. 331.

authorize by a resolution passed at a general meeting of the company. At such a meeting the company, instead of authorizing a definite loan, authorized the directors to borrow at their discretion. In suit upon a bond issued by the directors the company was held liable, upon the ground that it was of no consequence whether the resolution was or was not sufficient authority to the directors to borrow, and of no consequence, even, whether there was any resolution at all; inasmuch as a person dealing with the company has a right to presume that the company, which has put forward the directors as authorized to borrow, has taken every step requisite to empower it to borrow.

So in a case in Victoria, where a mining company was empowered to borrow money and mortgage its property upon a vote of the stockholders *and the directors*, it was held that the company was liable upon a loan obtained by the directors without such vote, for the lender was justified in assuming that there had been a meeting and vote of the shareholders in the manner directed.[14]

Aside from the consideration whether a requirement by statute or by charter that the bonds of a corporation shall be issued only upon a vote of the stockholders at a general meeting be regarded as a directory formality or an imperative one, the corporation is estopped by a waiver of such formality. Thus, where bonds issued in disregard of such formality were treated by the company as good, a stockholder who had attended meetings where the bonds were treated as good, upon subsequently filing a bill to restrain the company from redeeming the bonds, was held to be estopped from contesting their legality.[15]

§ 173a. **Creditors of a corporation cannot avail themselves of a statutory requirement for a stockholders' vote** to authorize a corporate mortgage or bond issue, such provision being for the benefit of stockholders only. So long as the corporators raise no objection to the proceeding, no one else can, as the matter does not concern the public at large. No principle of public policy is at stake, but the

[14] Tyson's Reef Co. In re, 3 W. W. & A., B. (Vict.) Cases at Law, 162. To same effect Thompson v. Natchez Water Co. 68 Miss. 423; 9 So. 821.

[15] Zabriskie v. Cleveland &c. R. Co. 23 How. (U. S.) 381, 398.

object is to prevent any mortgage except after due deliberation and after stockholders have been notified and have fully considered.[16] Consequently a vote by stockholders at a meeting which is not a regular meeting is sufficient as against outside creditors of the corporation.[17]

A mortgage made in pursuance of a vote of a majority of the stock, when the corporate charter required a three-quarters' vote to authorize a mortgage, is not void, but at most only voidable. The execution of it is undoubtedly an act within the scope of the corporate powers of the company, although the power to give the mortgage is not exercised in accordance with the charter. The evident intention of the statute in such cases is to furnish protection to certain individuals, and no question of public policy is involved, so the statute is sufficiently accomplished if such persons are given the liberty of avoiding it. Where no stockholder takes steps to avoid a mortgage so issued, and the corporation ratifies it by paying interest, it is held to be valid for all purposes.[18]

A mere usage of a religious society to authorize mortgages only by vote of its members, does not invalidate a mortgage executed by its trustees.[19]

Under the Colorado statute[20] declaring that a mortgage by a manufacturing corporation without a vote of a majority of the stock is absolutely void, a mineral water company was held to be a manufacturing corporation within the purview of the statute, and a mortgage executed by its directors could not be enforced.[21]

§ 173b. Notice of meetings. Inasmuch as a purchaser is not concerned with a requirement for the holding of corporate meetings to

[16] Beecher v. Rolling Mill Co. 45 Mich. 103; 7 N. W. 695; Hervey v. Ill. Midland R. Co. 28 Fed. 169; Central Trust Co. v. Condon, 67 Fed. 84; N. Y. E. Print. Co. In re, 110 Fed. 514; Anderson v. Bullock County Bank, 122 Ala. 275; 25 So. 523; Boyce v. Montauk Gas Coal Co. 37 W. Va. 73, 84; 16 S. E. 501.

[17] Campbell v. Argenta &c. Min. Co. 51 Fed. 1; Antietam Paper Co. v. Chronicle Pub. Co. 115 N. C. 143; 20 S. E. 366; William Firth Co. v. South Carolina Co. 122 Fed. 569.

[18] Bishop v. Kent & S. Co. 20 R. I. 680; 41 Atl. 255.

[19] Zion Church v. Mensch, 178 Ill. 225; 52 N. E. 858; 74 App. 115.

[20] Mills Ann St. Vol. 3, § 481.

[21] Carlsbad Water Co. v. New, 33 Colo. 389; 81 Pac. 34.

authorize the issuing of corporate obligations, for a still stronger reason he is not concerned with requirements respecting the preliminaries of such meetings, such as the publication of notices, or with regulations as to the manner of conducting such meetings.[22]

The objection that one director is not notified of the meeting at which the directors vote to authorize a mortgage cannot be made to affect the validity of the security, as that is a subject into which a mortgagee is not bound to examine.[23]

A contrary rule is followed in some jurisdictions, however, to the effect that a mortgage is invalid unless all directors have personal notice of the directors' meeting at which it is authorized.[24] The objection to this rule is that it charges the lender with responsibility for the fulfillment of preliminary requirements for the execution of the mortgage, and in that respect is inconsistent with the prevailing doctrine in regard to such proceedings as lead up to the execution of the mortgage.

§ 173c. A statute requiring a vote of two-thirds of the stock to authorize a mortgage has been held in California to apply to a railway mortgage.[25] But "bonded indebtedness," as used in the California Constitution providing for a stockholders' vote of authorization, does not embrace a non-negotiable note and mortgage executed by a private corporation.[26]

The Texas act[27] providing that no mortgage by a railway corporation shall be valid without a two-thirds' vote by stockholders in the company, and the act[28] requiring railway bonds to be approved by the State Railway Commissioners, do not apply, according to the doc-

[22] Fountain v. Carmarthen R. Co. L. R. 5 Eq. 316; Worcester &c. Exch. Co. In Matter of, 3 De G. M. & G. 180.

[23] Kuser v. Wright, 52 N. J. Eq. 825; 31 Atl. 397.

[24] Bank of Little Rock v. McCarthy, 55 Ark. 473; 18 S. W. 759; 29 Am. St. 60; Relley v. Campbell, 134 Cal. 175; 66 Pac. 220; Broughton v. Jones, 120 Mich. 462; 79 N. W. 691.

[25] Boyd v. Heron, 125 Cal. 453; 58 Pac. 64.

[26] Underhill v. Santa Barbara &c. Co. 93 Cal. 300; 28 Pac. 1049. See Market St. R. Co. v. Hellman, 109 Cal. 571; 42 Pac. 225, holding notices sufficiently definite.

[27] Tex. Rev. St. art. 4487 and 4402.

[28] Tex. Rev. St. art. 4584 h and i.

trine of the Court of Civil Appeals, to a mortgage executed to secure a debt already secured by a statutory lien and for the purpose of obtaining a longer term of credit.[29] Such mortgage being in effect a contract for the continuation of the statutory lien, is not to be treated as a borrowing *de novo*.

§ 173d. **Under the New York act**[30] requiring, before a mortgage of corporate property be made, that the written assent of stockholders owning at least two-thirds of the capital stock of the company shall be filed, mere giving the requisite consent, without filing, is a sufficient compliance to make the mortgage valid as against the company and its stockholders.[31] It has been held, furthermore, that filing the consent in writing simultaneously with the record of the mortgage is a sufficient compliance with the statute.[32]

§ 173e. **A change in the nature of the company's title to the property conveyed by mortgage** does not necessitate a new vote of authorization by the stockholders. Thus the fact that between the time of the stockholders' meeting and the making of the mortgage, the interest of the corporation in the land changed from an estate for years to a fee simple does not make it necessary to call a new meeting. A leasehold estate is property within the meaning of a notice sent to stockholders in regard to the issue of bonds of the company secured by a mortgage of its "property."[33]

§ 174. **A special requirement in respect to the execution of a corporate obligation,** such for instance as that it shall be signed or countersigned by a particular officer, is a directory formality which does not affect the right of one who has purchased in good faith without knowledge of the informality.[34]

[29] Galveston &c. R. Co. v. Fontaine, 23 Tex. Civ. App. 519; 57 S. W. 879.

[30] Laws of 1848, § 2, ch. 40; Amended Laws of 1864, ch. 517, and Laws of 1871, ch. 481.

[31] Martin v. Niagara Falls &c. Mfg. Co. 122 N. Y. 165; 25 N. E. 303.

[32] Welch v. Importers & T. Nat. Bank, 122 N. Y. 177; 25 N. E. 269. See, also, N. Y. E. Print. Co. In re, 110 Fed. 514.

[33] Evans v. Boston Heating Co. 157 Mass. 37; 31 N. E. 698.

[34] Brice Ultra Vires, 2d. Eng. ed. 643; Prince of Wales L. Ass. Co. v. Harding, E., B. & E. 183; Land

If the corporation has the power, under any circumstances, to issue negotiable securities, a *bona fide* holder has the right to presume that they were issued under the circumstances which gave the requisite authority.[35] Though the right to issue such securities is by the charter conditioned upon the performance of acts by the corporation or its officers relating to the management of its affairs, or relating to the execution of the securities, if a person dealing with the corporation finds the acts to be within the scope of its powers under its charter, he has a right to assume that all such conditions have been complied with.[36] Thus where the charter of a corporation authorized it to borrow money not exceeding two thirds of the capital paid in, and to secure the same by mortgage, and the directors adopted a resolution to increase the capital of the company, and soon afterwards, and before the new capital was paid in, authorized the execution of a mortgage for the amount of nearly two thirds the increased capital, it was held that the mortgage, being within the powers granted by the charter, and on its face having the appearance of being within such powers, was a valid security in favor of *bona fide* holders of the bonds, notwithstanding the directors had acted illegally in issuing them before the requisite capital had been paid in.[37]

§ 175. Securities issued ultra vires.—A distinction is to be observed between such cases and cases where the issuing of the securities is not within the power of the corporation under its charter, nor authorized by any statute. Persons dealing in the negotiable securities of a corporation are chargeable with notice of the power of a corporation under its charter to issue them. Moreover, if the power granted by the charter is subject to a condition relating either to the form of the securities, or to preliminary proceedings other than the acts of the corporation or its officers, securities not

Credit Co. of Ireland, In re, L. R. 4 Ch. 460; Hill v. Manchester &c. Works Co. 5 B. & Ad. 866; Allen v Sea &c. Ass. Co. 9 C. B. 574; Bargate v. Shortridge, 5 H. L. 297; Norwich Yarn Co. In re, 22 Beav. 143; Atwood v. Shenandoah &c. R. Co. 85 Va. 966; 9 S. E. 748.

[35] Hackensack Water Co. v. De Kay, 36 N. J. Eq. 548.

[36] Hackensack Water Co. v. De Kay, 36 N. J. Eq. 548.

[37] Hackensack Water Co. v. De Kay, 36 N. J. Eq. 548.

issued in accordance with such condition are subject to defences even in the hands of *bona fide* holders.[38]

§ 176. **In like manner requirements respecting the appointment or election of directors** or other officers of the corporation cannot affect the obligations of the company in the hands of *bona fide* holders for value.[39] The directors and other officers of the company who are found acting as such are presumed to be legally appointed.[40] It is well settled that if a corporation holds out to the world any one as a duly qualified officer, or acquiesces in his assumption to be such officer, it is as much bound as if he had been elected and qualified with every prescribed formality. The true legal ground of the obligation is that of estoppel.

§ 177. **Knowledge of the irregularity.**—Inasmuch as the reason upon which this class of cases depends is, that a person dealing with a corporation does not know, and has no adequate means of knowing, whether the preliminaries and formalities to the proper execution of an instrument have been complied with, it follows that, when the irregularity is one which appears upon the face of the instrument itself, the purchaser is bound to take notice of it.[41]

[38] Hackensack Water Co. v. De Kay, 36 N. J. Eq. 548.

[39] Bank of United States v. Dandridge, 12 Wheat. (U. S.) 64; Zabriskie v. Cleveland &c. R. Co. 23 How. (U. S.) 381; Carrugi v. Atlantic Ins. Co. 40 Ga. 135; 2 Am. R. 567; Brock v. Toronto &c. R. Co. 17 Grant (U. C. Ch.), 425.

[40] Anderson v. Duke &c. Co. 1 Australian Jurist, 161; County Life Ass. Co. In re, L. R. 5 Ch. 288.

[41] Athenaeum Life &c. Soc. In re, 4 K. & J. 549, 560. This qualification is pointed out by Page-Wood, V. C.: "There is no doubt an important distinction to be drawn, and it is drawn, in the case of the Royal British Bank v. Turquand, (6 Ell. & Bl. 327), between that which on the face of it is manifestly imperfect when tested by the requirements of the deed of settlement of the company, and that which contains nothing to indicate that those requirements have not been complied with. Thus where the deed requires certain instruments to be made under the common seal of the company, every person contracting with the company can see at once whether that requisition is complied with, and he is bound to do so; but where, as in the case I have last referred to, the conditions required by the deed consist

All that has been said upon this subject is premised of instruments which on their face purport to be the obligations of the corporation to be charged and to be duly executed; for a corporation is not liable upon instruments which do not purport to be made by it, even in the hands of a *bona fide* holder for value.[42]

Moreover, a distinction is to be observed between transactions which are within the general scope of a corporation without the aid of statutory authority, and those which depend altogether upon such authority for their validity. Requirements in the case of the former might be regarded as directory merely, which in the case of the latter might be regarded as conditions precedent to the exercise of the authority, or imperative formalities.

§ 178. Bonds issued under a voidable construction contract are voidable in the hands of the parties to whom they were originally issued with notice, or not in the ordinary course of business, but under circumstances which threw doubt upon their being holders for value. The construction contract being one which could not be enforced in equity when resisted by the stockholders of the corporation, the bonds issued under the contract are voidable at the election of the stockholders, unless they have passed into the hands of *bona fide* purchasers for value without notice. But notwithstanding the invalidity of the contract under which the bonds were issued,

of certain internal arrangements of the company,—for instance, resolutions at meetings and the like,—if the party contracting with the directors finds the acts which they undertake to do to be within the scope of their powers under the deed, he has a right to assume that all such conditions have been complied with. In the case last supposed, he is not bound to inquire whether the resolutions have been duly passed or the like; otherwise he would be bound to go back, and to inquire whether the meetings have been duly summoned, and so ascertain a variety of other matters into which, if it were necessary to make inquiry, it would be impossible for the company to carry on the business for which it is formed." See, also, North Hallenbeagle Mining Co. In re, L. R. 2 Ch. 321; Fountaine v. Carmarthen R. Co. L. R. 5 Eq. 316; Native Iron Ore Co. In re, L. R. 2 Ch. D. 345; Leggett v. N. J. M. & Banking Co. 1 N. J. Eq. 541; 23 Am. Dec. 728n; Hackensack Water Co. v. DeKay, 36 N. J. Eq. 548.

[42] Serrell v. Derbyshire &c. R. Co. 9 C. B. 811; on Appeal, 10 C. B. 910.

the holders in a suit to foreclose the mortgage are entitled to a decree for the payment of the sums actually expended for the construction under the contract which were payable in such bonds.[43]

§ 179. The bonds of a railroad company are not rendered void in consequence of being secured by an invalid mortgage, one for instance which the company had no power to execute. A corporation, like a natural person, has the right to carry on its legitimate business by all legal and necessary means not prohibited by law or by its charter. If it has the power to borrow money, it may issue its bonds for the money borrowed. In an action upon such contract obligation, the mortgage securing it is of no consequence in any way. A defect in a mortgage does not invalidate the mortgage debt, but only the security for it; and a want of power to make the mortgage does not affect the obligation of the bonds secured. Having a right to issue the bonds, the company is liable upon them without regard to the mortgage. A recital on the bonds themselves that they were "issued by the company in accordance with its charter to the amount of $500,000, and that the mortgage thereon receipted had been duly executed" does not prevent a recovery upon the bonds, though the company had no power to grant the mortgage.[44]

A provision in the mortgage not contained in the bonds secured by it, making the principal sum due after a default in the payment of interest for a certain time, does not enable a holder of the bonds in a suit upon them to recover the principal upon such default. Such provision has reference only to making the principal due in case of the foreclosure of the mortgage.[45]

Bonds are not rendered *ultra vires* or invalid by reason of its being *ultra vires* for the company issuing them to mortgage the property of another company to secure them, it being within its power to borrow money and issue evidences of indebtedness, and its bonds are not affected by want of power to make the mortgage by which they are in terms secured.[46]

[43] Thomas v. Brownville, Ft. K. & P. R. Co. 109 U. S. 522; 3 Sup. Ct. 315; Wardell v. Union P. R. Co. 4 Dill. (U. S.) 339; 103 U. S. 651.

[44] Philadelphia &c. R. Co. v. Lewis, 33 Pa. St. 33; 75 Am. Dec. 574.

[45] Mallory v. West Shore &c. R. Co. 3 J. & S. (N. Y.) 174.

[46] Illinois &c. Bank v. Pacific R. Co. 117 Cal. 332; 49 Pac. 197.

§ 180. **A certificate indorsed on a mortgage bond** of a corporation, stating that such bond is included in the mortgage, is to be construed with the mortgage and the bonds as a part of the same security.[47] A certificate on the face of mortgage bonds signed by the mortgage trustees, that the bonds are secured by a first mortgage to them in trust for the bondholders, is a representation binding upon the company when it has delivered the bonds in that state; but it does not of itself raise an absolute presumption that a purchaser relied upon the certificate. Consequently, in an action upon a note given to the company in part payment for such a bond, the question should be submitted to the jury whether the purchaser accepted the bond relying to any extent upon the certificate. The certificate is no part of the bond, and the representation contained in it does not control the obligation of the bond. It is an affirmation that the estate mortgaged is subject to no prior similar incumbrance. This affirmation does not constitute a warranty unless intended to have that effect. It is a representation in relation to a material fact which may have influenced the purchaser, but whether it did so is to be determined by the jury upon all the circumstances attending the transaction.[48]

§ 181. **The bonds of a corporation are not property until they have been issued** and delivered, and they are not before such delivery liable to be seized upon attachment or execution as property of the corporation.[49]

If a corporation has pledged its own bonds for a loan, the pledgee may waive the lien upon them created by the pledge, and may levy upon such bonds an execution obtained against the company for the debt.[50] But upon payment of the debt secured by the pledge, the bonds should be surrendered and cancelled and only the outstanding

[47] Benjamin v. Elmira &c. R. Co. 49 Barb. (N. Y.) 441.

[48] Edwards v. Marcy, 2 Allen (Mass.) 486.

[49] Sickles v. Richardson, 23 Hun (N. Y.) 559; Eastern Cable Co v. Great Western &c. Co. 164 Mass. 274, citing text. Richardson v. Green, 133 U. S. 30, 47; 10 Sup. Ct. 280; Coddington v. Gilbert, 17 N. Y. 489.

[50] Sickles v. Richardson, 23 Hun (N. Y.) 559.

bonds be allowed to share in the distribution of the assets of the corporation.[51]

When a corporation puts its bonds beyond its control by hypothecating them as security for loans, or for any other purpose it *issues* them within the meaning and intent of a statute requiring that no corporate bond shall be issued unless the company shall actually receive therefor seventy-five per cent. of their par value. A pledge with no stipulation that the bonds shall be accounted for at not less than seventy-cents on the dollar violates the statute and the bonds thus issued are void.[52] But no action for their cancellation or surrender can be maintained without a tender of the amount due the pledgee.[53] In the absence of statute, a sale of pledged bonds for a small amount does not affect the purchaser's title when no fraud is shown.[54]

§ 181a. An authority to sell does not authorize a pledge or mortgage. The sole authority being to negotiate bonds at a price not less than par for the purpose of raising money to pay debts, it is necessary to sell the bonds for money, or at least so to dispose of them as to pay the debts of the company. A pledge of bonds for existing obligations pays no debts of the company, but rather increases than diminishes such debts, and the pledgee cannot enforce the bonds as a holder for value.[55]

Where the intention is to sell bonds and pay debts but the parties cannot carry out the intention because the bonds cannot be sold, a pledge of them for a *bona fide* debt is valid. Recitals

[51] Bristol Trust Co. v. Jonesboro Trust Co. 101 Tenn. 545; 48 S. W. 228.

[52] Pfister v. Milwaukee Elec. R. Co. 83 Wis. 86; 53 N. W. 27. See Waterloo Organ Co. In re, 134 Fed. 345.

[53] Hinckley v. Pfister, 83 Wis. 64; 53 N. W. 21.

[54] Wheelwright v. St. Louis &c. Trans. Co. 56 Fed. 164. As to validity of bonds sold at discount see Toledo &c. R. Co. 95 Fed. 497.

[55] Shaw v. Saranac &c. Co. 144 N. Y. 220; 39 N. E. 73; 78 Hun (N. Y.) 7. An authority to sell does not authorize a pledge or mortgage. Cumming v. Williamson, 1 Sand. Ch. (N. Y.) 17; Merchants' Bank v. Livingston, 74 N. Y. 223. A pledge of bonds by a corporation to secure money borrowed for legitimate purposes is valid. Goldville Mfg. Co. In re, 118 Fed. 892.

that a company has issued bonds "which it is intended to put on the market and sell" and that "it needed additional means to pay its debts" and "had resolved to raise the same by issuance and sale of its bonds" do not override a provision for the equal payment of all bonds to any *bona fide* holder. It cannot be doubted that any person to whom the bonds were properly pledged for a debt of the company would be such a holder. The pledgees not being able to realize by a sale have the right to enforce the bonds themselves against the company.[56]

Though the resolution of the stockholders of a manufacturing company authorizing the issue of bonds specifies that they are to be used in payment, at par value, of any indebtedness of the company, or to raise money to conduct its business, it has been held that the officers of the company are not restrained from using the bonds by pledging them as collateral security for an existing debt.[57]

§ 182. First mortgage bonds, issued after the time of the execution of a second mortgage, have priority of the second mortgage bonds. The bonds carry the mortgage security until they have become commercially dishonored, or the mortgagor has done something to deprive itself of the power of putting them forth. "In my opinion," says Chief Justice Waite, "a subsequent mortgage is not sufficient for this purpose, unless it in terms limits the lien of the prior mortgage to bonds actually out, and provides against reissues. As it would be within the power of the second mortgage to require that all bonds not out should be destroyed, so as to prevent their getting on the market, it may be doubtful whether, as against a *bona fide* holder, the limitation contained in the second mortgage would be of any avail, unless the bonds themselves had been actually cancelled, or carry on their face the evidence of an extinguishment of their lien. It is so easy for one taking a subsequent lien to protect both himself and the public against loss in this particular, that

[56] Baxter v. Washburn, 76 Tenn. 1; Hunt v. Memphis Gaslight Co. 95 Tenn. 136; 31 S. W. 1006. See, also, Duncomb v. New York &c. R. Co. 84 N. Y. 190; Atwood v. Shenandoah Val. R. Co. (Va.) 9 S. E. 748.

[57] Lehman v. Tallassee Mfg. Co. 64 Ala. 567.

if he fails to do so he should be treated as guilty of a commercial wrong, and made to suffer accordingly."[58]

§ 183. A bondholder's rights cannot be impaired without his consent by any legislative enactment, such as substituting new bonds at a lower rate of interest for the old bonds, and declaring that the assent of the holders of the old bonds should be deemed to have been given to the substitution. A bondholder who does not assent to the substitution may sue upon his old bonds, and may recover the interest thereon as it matures, and the principal when that matures.[59]

§ 183a. A misnomer of the corporation in the signature to the bond does not render it invalid when it causes no ambiguity, the identity of a corporation being no more affected by a change of name than the identity of an individual.[60]

II. *Negotiability of Corporate Bonds.*

§ 184. Railroad bonds are usually made payable to the trustee named in the mortgage, or bearer, or to bearer generally, and they pass by delivery from hand to hand. They are in fact mere bills or notes, and as strictly negotiable as bank bills. Though called bonds, the word does not, *ex vi termini*, imply a contract under seal. As a matter of fact, such bonds are not generally under seal. If executed under seal, it might become necessary for the courts to disregard that incident, in order to give them that legal operation which the unwritten law of commerce has already given them. Therefore in an action upon such an instrument, although it be described as a bond, it may be declared upon, the same as a bill of exchange or promissory note, as an instrument importing a consideration.[61]

Debenture bonds in the form used in England, when made payable

[58] Claflin v. South Carolina R. Co. 4 Hughes (U. S.), 12.

[59] Gebhard v. Canada So. R. Co. 17 Blatchf. (U. S.) 416.

[60] Goldville Mfg. Co. In re, 118 Fed. 892.

[61] Ide v. Passumpsic &c. R. Co. 32 Vt. 297.

to bearer, are held to pass, like bills and notes, free from all equities existing against the original holders.[62] If such bonds are made payable to a person named or order, after indorsement by the payee, they become negotiable like bonds payable to bearer.[63] The decisions are, however, conflicting; and indeed until of late years such bonds were regarded as *prima facie* non-negotiable, and, therefore, subject to the equities existing between the corporation and the original holders.[64] The latest decisions favor the proposition that such instruments are, in equity at least, negotiable, free from the equities primarily attached to them.[65] In the case of the Imperial Land Company of Marseilles.[66] which had issued debenture bonds payable to bearer, and had sold them in open market, upon the winding up of the company it was held that equities which were admitted to exist in favor of the company against the parties to whom they were originally issued should not be admitted as against the present holders.

Scrip certificate issued by a foreign government or by a corporation on negotiating a loan promising to bearer, after all instalments have been duly paid, a bond for the amount paid, with interest, are by custom of all the stock markets of Europe negotiable instruments and pass by mere delivery to a *bona fide* holder for value. This is the English law. Any person taking such scrip in good faith obtains

[62] Imperial Land Co. of Marseilles, In re, 11 Eq. 478; 4 Cox's Joint Stock Cas. 241; Blakely Ordnance Co. In re, L. R. 3 Ch. 154, 159.

[63] General Estates Co. In re, L. R. 3 Ch. App. 758. See, also, Agra & Masterman's Bank, In re, L. R. 2 Ch. 391.

[64] See Anthenaeum Life &c. Society v. Pooley, 3 De G. & J. 294; Natal Investment Co. In re, L. R. 3 Ch. 355; Rhos Hall Co. In re, 17 W. R. 343.

[65] Brice Ultra Vires, 2d ed. 304; Hackensack Water Co. v. DeKay, 36 N. J. Eq. 548, 562.

[66] L. R. 11 Eq. 478, 488. Vice-Chancellor Malins, after reviewing the authorities, said: "I am clearly of opinion that, whether they were promissory notes, or bonds, or debentures, it was within the powers conferred upon the directors to issue them. Are they, then, promissory notes or debentures? or does it make any difference which they are in the result? My opinion is that, whichever they are, the result is the same, because they in any case make a contract by which the company have bound themselves to pay, not to any particular person, but to any person who may be the bearer, the sum appearing to be due upon their face."

a title to it independent of the title of the person from whom he took it.[67]

§ 185. A bond, although a sealed instrument, when made payable to bearer or holder, or order, is negotiable, with all the ordinary properties of a negotiable instrument.[68] Such bonds are not, like

[67] Goodwin v. Robarts, 1 App. Cas. 476; L. R. 10 Ex. 337; Rumball v. Metropolitan Bank, L. R. 2 Q. B. D. 194.

[68] White v. Vermont &c. R. Co. 21 How. (U. S.) 575, 577; Gelpcke v. Dubuque, 1 Wall. (U. S.) 175; Clark v. Iowa City, 20 Wall. (U. S.) 583; Haven v. Grand Junction R. & Depot Co. 109 Mass. 88; Aurora City v. West, 7 Wall. (U. S.) 82; Connecticut Mutual Ins. Co. v. Cleveland &c. R. Co. 41 Barb. (N. Y.) 9; Hackensack Water Co. v. DeKay, 36 N. J. Eq. 548; Morris Canal & Banking Co. v. Fisher, 9 N. J. Ch. 667, 699; Carr v. Le Fevre, 27 Pa. St. 413, 418; Chapin v. Vt. & Mass. R. Co. 8 Gray (Mass.) 575; Langston v. South Carolina R. Co. 2 S. C. 248; Williams, Ex parte, 18 S. Car. 299; Mercer County v. Hacket, 1 Wall. (U. S.) 83, 95; Knox County v. Aspinwall, 21 How. (U. S.) 539; Kneeland v. Lawrence, 140 U. S. 209; 11 Sup. Ct. 786; Chicago R. Co. v. Merchants' Bank, 136 U. S. 268; 10 S. Ct. 999; DeHass v. Roberts, 59 Fed. 853; Zabriskie v. Cleveland &c. R. Co. 23 How. (U. S.) 381, 400; Hubbard v. N. Y. & Harlem R. Co. 36 Barb. (N. Y.) 286; Craig v. Vicksburg, 31 Miss. 216; Beaver v. Armstrong, 44 Pa. St. 63, 68; Rice v. Southern &c. R. Co. 9 Phila. (Pa.) 294; Blake v. Livingston County, 61 Barb. (N. Y.) 149; Brainerd v. New York &c. R. Co. 25 N. Y. 496; Dinsmore v. Duncan, 57 N. Y. 573; 15 Am. R. 534; Welch v. Sage, 47 N. Y. 143; 7 Am. R. 423; Hodges v. Shuler, 22 N. Y. 114; Virginia v. Chesapeake &c. Co. 32 Md. 501; Wickes v. Adirondack Co. 2 Hun (N. Y.), 112; Elizabeth v. Force, 29 N. J. Eq. 587; Reid v. Bank of Mobile, 70 Ala. 199; Blackman v. Lehman, 63 Ala. 547; Lehman v. Tallassee Mfg. Co. 64 Ala 567; National Ex. Bank v. Hartford, P. & F. R. Co. 8 R. I. 375; 91 Am. Dec. 237; American Nat. Bank v. American Wood Paper Co. 19 R. I. 149; 61 Am. St. 746.

Contra, but not to be regarded as authorities on this point, Diamond v. Lawrence County, 37 Pa. St. 353; 78 Am. Dec. 429; Clarke v. Janesville, 1 Biss. (U. S.) 98: Jackson v. York &c. R. Co. 48 Me. 147; Myers v. York &c. R. Co. 43 Me. 232.

Nelson, J., pronouncing the decision of the United States Supreme Court in White v. Vermont &c. R. Co., first above cited, said: We think the usage and practice of the companies themselves, and of the capitalists and business men of the country dealing in them, as well as the repeated decisions or recognition of the principle by courts and judges of the highest respectability, have settled the question.

promissory notes and bills of exchange, negotiable under the law merchant; but being designed to be passed from hand to hand by delivery, they have by common usage become assignable by delivery, so as to enable the holder to maintain an action on them in his own name.[69] Though not exactly governed by the law merchant, they are entitled to the privileges of commercial paper.[70] And a purchaser in good faith and for value, in the usual course of business, is not affected by any irregularity in the original issuing of the

Indeed, without conceding to them the quality of negotiability, much of the value of these securities in the market, and as a means of furnishing the funds for the accomplishment of many of the greatest and most useful enterprises of the day, would be impaired. Within the last few years, large masses of them have gone into general circulation, and in which capitalists have invested their money; and it is not too much to say, that a great share of the confidence they have acquired, as a desirable security for investment, is attributable to this negotiable quality, as well on account of the facility of passing from hand to hand, as the protection afforded to the bona fide holder."

No indorsement is necessary when the bonds are payable to bearer, but a mere delivery is sufficient. Brewton v. Glass, 116 Ala. 629. And the same rule has been applied under a statute requiring an indorsement to transfer instruments under seal, a corporate seal bearing a strong analogy to the signature of a natural person and being its substantial equivalent. Pittsburg &c. R. Co. v. Lynde, 55 Ohio St. 23; 44 N. E. 596.

[69] Bunting v. Camden &c. R. Co. 81 Pa. St. 254; 15 Am. Ry. R. 570; Carr v. Le Fevre, 27 Pa. St. 413.

[70] Junction R. Co. v. Cleaney, 13 Ind. 161. "Usages of trade and commerce are acknowledged by the courts as part of the common law, although they have been unkown to Bracton or Blackstone. And this malleability to suit the necessities and usages of the mercantile and commercial world is one of the most valuable characteristics of the common law. When a corporation covenants to pay to bearer, and gives a bond negotiable, with negotiable qualities, and by this means obtains funds for the accomplishment of the useful enterprises of the day, it cannot be allowed to evade the payment by parading some obsolete judicial decision that a bond, for some technical reason, cannot be made payable to bearer. That these securities are treated as negotiable by the commercial usages of the whole civilized world, and have received the sanctions of judicial recognition, not only in this court, but of nearly every state in the Union, is well known and admitted." Per Grier, J., in Mercer County v. Hacket, 1 Wall. (U. S.) 83, 95.

bonds, or any misapplication of them by the immediate transferee, of which the purchaser had no notice, actual or constructive.[71]

§ 186. **This rule prevails even in Illinois,** where it is held that the assignee of a negotiable note secured by mortgage takes the mortgage subject to all the equities which existed in favor of the mortgagor against the mortgagee.[72] This rule in regard to mortgages has no application to deeds of trust given to secure railroad coupon bonds intended to be thrown upon the market and circulated as commercial paper, and to be used as securities for permanent investments.[73] Under the constitutional provision against the issue of bonds except "for money, labor, or property," if bonds are regularly issued for a present consideration and accepted by the proper officer of the company, they will be regarded as having been issued for "money, labor, or property" within the meaning of such provision, although the proceeds of such bonds are subsequently diverted to other than corporate purposes; and the purchaser of such bonds, who has acted in good faith, or his assignee, cannot be affected by such subsequent misappropriation.[74]

§ 187. **The holder of the negotiable bonds of a corporation is presumed to be a rightful holder of them** until the contrary appears. When he seeks to recover upon them, it is not incumbent

[71] Gilman v. New Orleans &c. R. Co. 72 Ala. 566; Morton v. New Orleans &c. R. Co. 79 Ala. 590; Grand Rapids &c. R. Co. v. Sanders, 17 Hun (N. Y.), 552; Cochran v. Foxchase Bank, 209 Pa. St. 34; 58 Atl. 117; 103 Am. St. 976n; Mason v. Frick, 105 Pa. St. 162; 51 Am. R. 191; Beaver v. Armstrong, 44 Pa. St. 63; Carpenter v. Rommel, 5 Phila. (Pa.) 34. In Pittsburg &c. R. Co. v. Lynde, 55 Ohio St. 23; 44 N. E. 596, it was said railroad bonds "are instruments of trade and commerce in the broad sense of those terms; they are designed for sale in the money markets of both Europe and America; they are made payable to bearer for the express purpose of facilitating their negotiability."

The rights of any bona fide purchaser in the chain of title inures to the benefit of the last holder of a bond. Central R. &c. Co. v. Farmers' &c. Co. 116 Fed. 700.

[72] Jones' Mortgages, § 838; Olds v. Cummings, 31 Ill. 188.

[73] Peoria &c. R. Co. v. Thompson, 103 Ill. 187.

[74] Peoria &c. R. Co. v. Thompson, 103 Ill. 187.

upon him to show how he or any previous holder obtained them.[75] But, as in case of other negotiable paper, if fraud or illegality in the inception of negotiable paper be shown, an indorsee, or subsequent purchaser, before he can recover, must prove that he is a holder for value. The mere possession of the bonds under such circumstances is not enough.[76]

§ 188. The fact that an unpaid coupon is attached to a bond not yet due is not alone sufficient to affect the position of a purchaser of the bond and the subsequently maturing coupons as a *bona fide* purchaser. This alone does not subject the bond to defences which may be good against the original holder.[77]

But it has been held that the fact that coupons overdue and unpaid for several years were attached to the bond at the time of pur-

[75] Chicago &c. Land Co. v. Peck, 112 Ill. 408.

[76] Simmons v. Taylor, 38 Fed. 682; Smith v. Sac Co. 11 Wall. (U. S.) 139; Stewart v. Lansing, 104 U. S. 505; Shellenberger v. Altoona &c. R. Co. 212 Pa. St. 413; 61 Atl. 1000.

[77] Cromwell v. County of Sac, 96 U. S. 51, 58. "To hold otherwise," said Field, J., speaking for the Supreme Court of the United States, "would throw discredit upon a large class of securities issued by municipal and private corporations, having years to run, with interest payable annually or semi-annually. Temporary financial pressure, the falling off of expected revenues or income, and many other causes having no connection with the original validity of such instruments, have heretofore, in many instances, prevented a punctual payment of every instalment of interest on them as it matured; and similar causes may be expected to prevent a punctual payment of interest in many instances hereafter. To hold that a failure to meet the interest as it matures renders them, though they may have years to run, and all subsequent coupons, dishonored paper, subject to all defences good against the original holders, would greatly impair the currency and credit of such securities, and correspondingly diminish their value." See, also, Thompson v. Perrine, 106 U. S. 589; 1 Sup. Ct. 564, 568; Railway Co. v. Sprague, 103 U. S. 756; National Bank of N. A. v. Kirby, 108 Mass. 497; Morgan v. United States, 113 U. S. 476, 501; 5 Sup. Ct. 588; Boss v. Hewitt, 15 Wis. 260; State v. Cobb, 64 Ala. 127; Morton v. New Orleans &c. R. Co. 79 Ala. 590; McLane v. Placerville &c. R. Co. 66 Cal. 606; 6 Pac. 748; Buffalo L. T. & S. D. Co. v. Medina Gas Co. 162 N. Y. 67; 56 N. E. 505.

A legacy of a bond carries with it an overdue coupon which was attached to the bond at the time of the testator's death. Ogden v. Pattee, 149 Mass. 82; 21 N. E. 227.

chase was a circumstance of suspicion sufficient to put a purchaser on guard.[78] The reasoning of the court in the Minnesota case would equally make a bond with a single coupon overdue and unpaid dishonored paper; for they say the interest, equally with the principal, is a part of the debt secured, and it is immaterial whether the whole or only a part of the debt is overdue. When due, the plaintiff has a right of action for the recovery of the interest, in the same way that he would have for the recovery of any other instalment on the bond. In view of the authority and reasoning of the Supreme Court of the United States and of the Supreme Court of Massachusetts on this subject, the above case cannot be regarded as law. A purchaser in good faith of ordinary coupon bonds is unaffected by want of title in the vendor. The possession of such bonds carries the title with it to the holder. Even suspicion on the purchaser's part of defect of title in the seller, or knowledge on the purchaser's part of circumstances which would excite such suspicion in the mind of a prudent man, or gross negligence on the part of the purchaser in purchasing the bonds, does not defeat his title. That is affected only by bad faith on his part. On a question of such faith, the burden of proof lies on the party who assails the possession.[79] But where the defendant has shown strong circumstances of fraud in the origin of the instrument, such evidence casts upon the holder of it the necessity of showing that he gave value for it before maturity.[80]

§ 189. Circumstances under which purchasers are not bona fide purchasers for value. Where bonds at the time of their purchase had attached coupons overdue for several years, and as between the mortgagor and the trustee the bonds, both as to principal and interest, had been declared due, and there was pending a cross-bill, brought by the trustee seeking a decree of foreclosure, the purchasers

[78] First National Bank v. Scott County, 14 Minn. 77; 100 Am. Dec. 194n; Parsons v. Jackson, 99 U. S. 434; Morton v. New Orleans &c. R. Co. 79 Ala. 590; Central R. &c. Co. v. Farmers' &c. Co. 116 Fed. 700.

[79] Murray v. Lardner, 2 Wall. (U. S.) 110, approving Goodman v. Harvey, 4 Ad. & L. 870, and affirming Goodman v. Simonds, 20 How. (U. S.) 343. See, also, Cromwell v. Sac County, 96 U. S. 51.

[80] Smith v. Sac County, 11 Wall. (U. S.) 139.

cannot assert that they are the holders of commercial paper bought before maturity for value, and therefore entitled to the protection accorded to *bona fide* holders of negotiable paper. If any of the bonds so purchased were then valid and enforceable in the hands of the parties from whom they were purchased, they are enforceable by the present holders for the full amount due thereon, regardless of the sum paid for them, or of the fact that they were purchased for a nominal price as a speculation. If, however, the bonds, or any of them so purchased, were invalid and void in the hands of the persons from whom they were purchased, validity is not imparted to them by the purchase so made.[81]

§ 190. Although they contain an agreement for their conversion into stock, the coupon bonds of a railroad company, payable to a person named or bearer, are negotiable instruments, with the privileges of such paper; and so, although the bonds contain an agreement on the part of the company to make what is termed "scrip preferred stock" in exchange therefor at any time within ten days after any dividend should become payable on such stock.[82] Such an agreement is independent of the pecuniary obligation contained in the instrument, and does not change the duty of the company with respect either to the principal or interest stipulated. Whether the agreement to convert into preferred stock is of any value or not, it can in no way affect the negotiable character of the instrument; and therefore the title of a *bona fide* holder is good, although the bonds may have been stolen from the former owner.

Where it further appeared that to such bonds there was attached by a pin the certificate of such preferred stock, which stated that the bondholder was entitled to a certain number of shares of such stock, and that upon the surrender of the bonds he should be entitled to receive the stock, the bonds having been stolen and negotiated to one who took them without actual notice of any defect in the title to them, the fact that the certificate originally attached to the bonds had previously been detached was held not to be a circumstance sufficient to put the person who took the bonds upon inquiry as to the

[81] Simmons v. Taylor, 38 Fed. 682; Parsons v. Jackson, 99 U. S. 434.

[82] Hotchkiss v. National Banks, 21 Wall. (U. S.) 354.

title of the previous holder.[83] The title of a person who takes negotiable paper before due for a valuable consideration can only be defeated by bad faith on his part, which implies guilty knowledge or wilful ignorance of facts impairing his title; and the burden of proof lies on the assailant of the title.

§ 191. **The negotiability of bonds executed in negotiable form may be destroyed by stipulations which render their payment subject to contingencies** not within the control of their holders; and such bonds in the hands of innocent purchasers are exposed to any defence existing thereto, as between the original parties to the instrument. Such stipulations contained in the mortgage referred to in the bonds have the same effect as if they were contained in the bonds. It is essential to the negotiability of bonds that they should provide for payment to a person or order, or to bearer, of a certain sum of money at a time capable of exact ascertainment. If, therefore, bonds or the coupons attached thereto are subject to the condition that the time of their payment may be changed, altered, or postponed from time to time at the option of a majority of the holders of other bonds issued simultaneously therewith, the bonds and coupons are deprived of one of the essential characteristics of negotiable paper.[84]

But the fact that bonds are redeemable by annual drawings conducted by the trustee is not sufficient to deprive them of their usual attribute of negotiability, the promise of the obligor being to redeem all of them by a date certain.[85]

§ 192. **Registered bonds.** In like manner a provision in a bond that it may be registered and made payable by a transfer only on the books of the company, does not of itself, before such registration, make the bond non-negotiable by mere manual transfer.[86]

[83] Hotchkiss v. National Banks, 21 Wall. (U. S.) 354; Murray v. Lardner, 2 Wall. (U. S.) 110; Welch v. Sage, 47 N. Y. 143; 7 Am. R. 423.

[84] McClelland v. Norfolk &c. R. Co. 110 N. Y. 469, 476; 18 N. E. 237.

[85] Dickerman v. Northern Trust Co. 176 U. S. 181; 20 Sup. Ct. 311.

[86] Savannah &c. R. Co. v. Lancaster, 62 Ala. 555; Reid v. Bank of Mobile, 70 Ala. 199; Dickerman v. Northern Trust Co. 176 U. S. 181; 20 Sup. Ct. 311.

Corporate bonds issued by a city contained a provision that they might be registered on the books of the comptroller, and that after registration they could be transferred only by the indorsement of the comptroller. It was held that the proper remedy to force the comptroller to register the bonds was an action for specific performance; such duty being purely contractual, could not be enforced by mandamus.[87]

Even a registered municipal bond which can only be transferred at the office of the city treasurer may be so dealt with that a *bona fide* purchaser for value might acquire a good title without the assent of the former owner. This was held where the owner indorsed such a bond in blank and intrusted it to his banker. "A blank indorsement of such an instrument," says Chief Justice Holmes, of the Massachusetts Supreme Court, "signifies that some person is expected to have the right to fill in the blank. On its face it does not indicate who that person is. By itself it is ambiguous. If, however, the general understanding of all concerned gives it a certain meaning, then it has that meaning by the same convention that gives a certain meaning to written or spoken words. The combination of words and blank is a sign as truly as a completed sentence—a sign which conveys an idea as definitely as if the word 'bearer' had been written in. The extent to which the owner shall be estopped by permitting the sign to remain upon the instrument in that form may be enlarged or limited by considerations of public policy more or less articulate. No doubt if such an instrument were stolen from the owner and indorser before his indorsement had become effective by a transfer, or before the instrument had been put into other hands, even a *bona fide* purchaser would not get a title, and a different rule would be established from that which is established in the interest of the currency with regard to bank notes used as money, and which might be extended to other bills and notes which are negotiable in the true sense. . . . But if the owner of the instrument intrusts it to another, he does so charged with no-

[87] Benwell v. Newark, 55 N. J. Eq. 260; 36 Atl. 668, where the registration is not required by statute the bonds are still transferable by delivery though registered in the city clerk's office. Manhattan Sav. Instn. v. New York Nat. Ex. Bank, 170 N. Y. 58; 88 Am. St. 640.

tice of the power to deceive which he is putting into the other's hands, and if deception follows he must bear the burden."[88]

§ 193. **The fact that bonds under seal show that the obligor is required to keep a sinking fund** for their redemption, and that they may be paid before the day stipulated for their payment, does not affect their negotiability.[89]

§ 194. **Bonds and debentures which are not negotiable instruments are merely choses in action,** not assignable at law, and purchasers, though buying them in good faith for value, without notice, take them subject to the equities attached. Therefore, if such debentures are issued by the chairman of the directors in fraud of the company, the company may, upon the discovery of the fraud, disclaim its liability. Although the transfer be recorded upon the books of the company, and interest upon the debentures be paid for a year or more, until an investigation of the company's affairs by the stockholders revealed the fraud, these acts will not have the effect of a confirmation of the title of one who has purchased the debentures in the market in the ordinary course of business. The stockholders, not being bound by the loan originally, are not bound by payments of interest or other acts without their knowledge.[90]

Any information or notice to a purchaser of such bonds of any fact or circumstance calculated to excite suspicion, and which, if followed up, would lead to the discovery of a latent equity or defect of title, is equivalent to actual notice.[91]

Of course, a purchaser of overdue bonds, though negotiable, takes

[88] Scollans v. Rollins, 179 Mass. 346, 352; 60 N. E. 983; Scollans v. Rollins, 173 Mass. 275; 53 N. E. 863. See Clarkson Home v. Missouri &c. R. Co. 182 N. Y. 47; 74 N. E. 571; 70 L. R. A. 787, for the liability of a broker who innocently aided a thief in getting possession of a registered bond.

Changing a registered bond to one payable to bearer at the instance of one trustee under a will has been held not to make the transfer company liable for the subsequent misappropriation of the bond. Duckworth v. Ocean Steamship Co. 98 Ga. 193; 26 S. E. 736.

[89] Union Cattle Co. v. International Trust Co. 149 Mass. 492; 21 N. E. 962.

[90] Athenaeum Life &c. Soc. v. Pooley, 3 De G. & J. 294.

[91] Spence v. Mobile &c. R. Co. 79 Ala. 576.

them subject to the rights of antecedent holders to the same extent as other paper bought after its maturity.[92]

§ 195. Written contracts are not necessarily negotiable because by their terms they enure to the benefit of the bearer. Whether they are negotiable in the sense that innocent holders of them are protected in their title to them, depends in part upon the subject-matter of the contract. Hence, a certificate by which a person acknowledges that he has received a certain number of shares of stock in a corporation, entitling the bearer to so many dollars in certain bonds to be issued, is not free, in the hands of the transferee, from the equities which would have affected it in the hands of the original holder.[93] Certificates of stock, though they pass from hand to hand by delivery, do not partake of the character of negotiable paper, and therefore the assignee has no better title than the assignor.[94]

A bond is rendered non-negotiable by inserting in it a provision to do something else than pay money, as, for instance, to feed and clothe a slave.[95]

§ 196. A purchaser of bonds which refer to the mortgage securing them is bound by any statements contained in the mortgage affecting the security. The mortgage referred to necessarily becomes a part of the bonds in determining exactly what they are represented to be. Thus the New York, Kingston and Syracuse Railroad Company, having a mortgage of $2,000,000 upon its road, executed another mortgage of the same and some additional property to secure bonds to the amount of $4,000,000, which were described on their face as first mortgage consolidated bonds, and indorsed "consolidated first mortgage bonds." These bonds referred to a mortgage from which it appeared that it was intended to substitute a portion of the bonds for the first mortgage bonds already issued, and to

[92] Vermilye v. Adams Exp. Co. 21 Wall. (U. S.) 138.

[93] Railroad Co. v. Howard, 7 Wall. (U S.) 392.

[94] Weaver v. Barden, 49 N. Y. 286; 3 Lans. (N. Y.) 338; Dunn v. Commercial Bank, 11 Barb. (N. Y.) 580; Leitch v. Wells, 48 N. Y. 585; Salisbury Mills v. Townsend, 109 Mass. 115; Shaw v. Spencer, 100 Mass. 382; 1 Am. R. 115.

[95] Knight v. Wilmington &c. R. Co. 1 Jones L. (N. Car.) 357.

devote the remainder to the extension and completion of the road. In an action against the company and its president and directors, grounded on fraud in issuing the bonds, the plaintiffs alleged that they furnished certain materials to the contractor engaged in building the extension of the road, under an agreement with him to receive in payment notes secured by first mortgage bonds of the defendant corporation; and that they took the consolidated first mortgage bonds in the belief that they were the first mortgage bonds of the company, when in fact they were not. The Supreme Court of New York, however, regarded the use of the word "consolidated" as sufficient to put a purchaser upon his inquiry, even if it did not in itself control and qualify the statement that the bonds were first mortgage bonds.[96] Moreover, the bonds referring to the mortgage, the purchaser is affected with its contents; and that, on inspection, would have disclosed the fact that the design was to substitute these bonds for bonds previously issued and secured by mortgage, and would have dictated the propriety, as a matter of security, of ascertaining whether the holders of the old bonds were willing to make the exchange or accept the new bonds. These bonds would not all become first mortgage bonds without such change; but there is no allegation or proof that the directors of the corporation knew that the substitution would not be accomplished, or that they increased the issue of bonds unlawfully, or for a fraudulent purpose; on the contrary, it must be inferred that the directors believed in the success of the scheme, and that the contractor, knowing the precise character of the bonds, must have had faith in their ultimate value. "The case presented seems, therefore, to be bald in several respects, namely: the absence of fraudulent design or purpose in issuing the bonds; the absence of any charge connecting the defendants, the directors, with the delivery of them to the plaintiffs; the absence of allegation or charge showing the plaintiffs to be *bona fide* holders for value; and the absence of any representation by the defendants, the directors, aside from the bonds themselves, which explained their design and purpose sufficiently to notify the purchaser or person taking them of their character, or that he should examine." In con-

[96] Caylus v. New York &c. R. Co. 10 Hun (N. Y.), 295. The same doctrine is illustrated in National Salt Co. v. Ingraham, 122 Fed. 40.

clusion, the court remark that it is not intended by the result to justify the proceeding complained of; that first mortgage bonds ought to mean first mortgage bonds, and should not be issued until all the preliminaries to make them such have been observed and performed.

In like manner, if the bonds refer to the statute under authority of which they were issued or indorsed, every person taking them directly from the company issuing them is put upon inquiry, and is chargeable with notice of the requirements of the statute, and of the uses and purposes for which they could be legally issued and transferred.[97]

The purchaser is also affected with notice of a statute authorizing the consolidation of railroads, and takes the bonds subject to the liability that the road that issued them may consolidate with another.[98]

§ 196a. Sufficiency of reference to mortgage.—The duty of a bondholder to inquire into the provisions of the mortgage may be limited by the general nature of the recital in the bonds. A mere recital that the bonds are secured by a trust deed, with only a general reference to a description of the deed, does not affect the negotiability of the bond and is not sufficient to put purchasers on inquiry, so as to constitute notice to a *bona fide* purchaser that they are to be enforced at law only after an attempt to collect through trustees as provided in the deed. Such a recital alone does not import into the bond special provisions not affecting the nature or enforcement of the security, and at variance with the tenor of the bond itself. The policy of the law is to hold such instruments negotiable

[97] Gilman v. New Orleans &c. R. Co. 72 Ala. 566; Morton v. New Orleans &c. R. Co. 79 Ala. 590.

[98] Tysen v. Wabash R. Co. 11 Biss. (U. S.) 510. On the other hand, where the consolidation of interstate roads has not been authorized, consolidated bonds are invalid, as a domestic corporation has no authority to issue bonds for the construction of a railway in a foreign state. American Trust Co. v. Minnesota & N. W. R. Co. 157 Ill. 641; 42 N. E. 153. The obligation of a county on subscription of bonds in aid of a railway inures to the benefit of a consolidated road which includes the original beneficiary. Monill v. Smith Co. 89 Tex. 529; 36 S. W. 56.

unless there is enough on the face of the bond to suggest inquiry in respect to the existence of facts destroying their negotiability.[99]

A provision restraining proceedings for foreclosure on the part of individual bondholders until after a requisition made upon trustees by a certain proportion of the bondholders and a refusal to comply therewith is valid and obligatory upon the individual bondholders as respects the enforcement of the security. Bondholders, subject to reasonable limitations, may be bound by stipulations in the mortgage of this character, waiving a default, and providing, subject to certain conditions, for foreclosure by the trustee exclusively. The interests of the bondholders as a class and the nature of the security are to be considered.[100]

§ 197. A bond of a corporation for the payment of money, negotiable in form, but delivered with the name of the payee in blank, may be filled in with the name of the holder and sued in his name.[101] In England the law has been settled otherwise, upon the principle that the authority of an agent to make a deed for another must be by deed, and that he cannot fill the blank, either under an implied or express parol authority from the maker. Baron Parke, in a case where a certificate of stock was issued and filled up in this way, said:[102] "This is an attempt to make a deed transferable and negotiable like a bill of exchange or exchequer bill, which the law does not permit." But in this country, so far as corporate bonds for the payment of money are concerned, this objection has no weight. On the contrary, the negotiable quality of such instruments is regarded

[99] Guilford v. Minneapolis &c. R. Co. 48 Minn. 560; 51 N. W. 658; 31 Am. St. 694. The original decision of this case was contrary to the statements made in the text; but this was reversed on rehearing. The original decision was that by a reference to the mortgage in the bond, holders of bonds and coupons are put on inquiry and charged with notice of the terms of the trust deed, and are bound by the conditions therein.

[100] Siebert v. Minneapolis &c. R. Co. 52 Minn. 148; 53 N. W. 1134; 20 L. R. A. 535n; 38 Am. St. 530.

[101] White v. Vermont &c. R. Co. 21 How. (U. S.) 575; Chapin v. Vermont &c. R. Co. 8 Gray (Mass.), 575; Dutchess Co. Ins. Co. v. Hachfield, 1 Hun (N. Y.), 675; 47 How. Pr. (N. Y.) 330; and see Michigan Bank v. Eldred, 9 Wall. (U. S.) 544.

[102] Hibblewhite v. M'Morine, 6 Mees. & W. 200; and see Enthoven v. Hoyle, 13 C. B. 373.

as one of their chief advantages, and this quality has been established by long usage. When, therefore, a corporation issues bonds in blank, it is plainly its intention to become bound by every person by whom any of the bonds may be holden; and the implication is unavoidable that the corporation consents that any *bona fide* holder for value may perfect the contract by inserting at his own pleasure his name as obligee of the bond in the blank space which has been left for that purpose. "In other words," says Mr. Justice Nelson,[103] "the company intended, by the blank, to leave the holder his option as to the form or character of negotiability, without restriction. If the utmost latitude in this respect was not intended, why leave the payee in blank when issuing the bonds, or why not fix the limit of negotiability, or negative it altogether? To adopt any other conclusion would seem to us to be unjust to the company, for then the blank would be wholly unmeaning; or, if any, a meaning calculated, if not intended, to embarrass the title of the holder."

§ 198. **A condition indorsed upon debenture bonds, that at stated times a portion of the bonds should be drawn** and paid off, was held to prevent their being negotiable at law, although in terms made payable to bearer; and moreover it was held that it was not competent for corporations to attach the incident of negotiability to such instruments contrary to the general law; and that the custom to treat them as negotiable, being of recent origin, and not the law merchant, made no difference, as such a custom, though general, could not attach an incident to a contract contrary to the general law.[104] This decision was, however, questioned by the Court of Exchequer Chamber.[105] The case arose with reference to scrip is-

[103] In White v. Vermont &c. R. Co. 21 How. (U. S.) 575.

[104] Crouch v. Credit Foncier of England, L. R. 8 Q. B. 374.

[105] Goodwin v. Robarts, L. R. 10 Ex. 337, 339, 356. "While we quite agree that the greater or less time during which a custom has existed may be material in determining how far it has generally prevailed, we cannot think that, if a usage is once shown to be universal, it is the less entitled to prevail because it may not have formed part of the law merchant as previously recognized and adopted by the courts. It is obvious that such reasoning would have been fatal to the negotiability of foreign bonds, which are of comparatively modern origin, and yet, according to Gorgier v. Mieville, 3 B. & C. 45, are to be

sued in England by the agent of a foreign government upon the payment of the first instalment of a subscription to bonds afterwards to be issued. The scrip was in terms payable to bearer, and by the usage of bankers and dealers in public securities was transferable by mere delivery; and the court decided that it passed by such delivery to a *bona fide* holder for value.[106] This case must be regarded as deciding, after considerable conflict of authority, that instruments payable to "bearer," or "holder," or "transferee," or "order," and the like, which by usage are transferable by delivery, are in law fully negotiable.

§ 199. **Bonds of a corporation payable to a person named, "or assigns,"** are assignable at law, so as to enable the holder to maintain an action in his own name only by an indorsement in writing by the obligee.[107] In equity they may be assigned by delivery merely; but then an action upon them must be brought in the name of the obligee.

Although the instrument be not strictly negotiable at law, yet if it contains anything to show that the parties intended to renounce the ordinary rule that the assignee of a chose in action takes it subject to the equities between the original parties, or if the company making it has held it out to the world as free from such equities, the company is barred from subsequently setting up such equities. Thus, where debentures payable to a person, "his executors, administrators,

treated as negotiable. We think the judgment in Crouch v. The Credit Foncier, L. R. 8 Q. B. 374, may well be supported on the ground that in that case there was substantially no proof whatever of general usage. We cannot concur in thinking that if proof of general usage had been established it would have been a sufficient ground for refusing to give effect to it that it did not form part of what is called 'the ancient law merchant.'"

[106] The scrip was in the following terms: "Scrip for one hundred pounds stock, No. ——. Received the sum of twenty pounds, being the first instalment of twenty per cent. upon one hundred pounds stock; and on payment of the remaining instalments at the periods specified, the bearer will be entitled to receive a definitive bond or bonds for one hundred pounds, after receipt thereof from the imperial government."

[107] Bunting v. Camden &c. R. Co. 81 Pa. St. 254; 15 Am. Railw. R. 570; Hubbard v. New York &c. R. Co. 36 Barb. (N. Y.) 286.

and assigns," were issued to a shareholder in the company who assigned them, it was held in a suit against the company by the assignee that the company could not set up in defense the claim that the original holder was indebted for unpaid calls upon his shares, and that by the articles of association the company had a primary lien on the debentures of any member who might be indebted to it. It was contemplated that the original holder should assign the debentures if he saw fit, and that he could not practically do if they were subject to the equity claimed.[108]

§ 200. A purchaser of negotiable bonds before due, for a valuable consideration, in good faith and without actual knowledge or notice of any defect of title, holds them by a title valid as against every other person.[109] Even gross negligence at the time of purchase does not alone defeat the purchaser's title. A purchaser may have had suspicion of a defect of title, or knowledge of circumstances which would excite such suspicion in the mind of a prudent man; or he may have disregarded notices of stolen bonds; and yet, if he has purchased for value in good faith, his title cannot be impeached. Such suspicion, or ground of suspicion, or of knowledge on his part, may be evidence of bad faith; but before his title can be impeached his bad faith must be established. It must be shown that he did not purchase honestly.[110] The protection accorded to a purchaser of such bonds extends to the mortgage given to secure them.[111]

[108] Higgs v. Northern &c. Tea Co. L. R. 4 Ex. 387, 396. See, also, Crouch v. Credit Foncier, L. R. 8 Q. B. 374, 385; Goodwin v. Robarts, L. R. 10 Ex. 337.

[109] Imperial Land Co. of Marseilles, In re, L. R. 11 Eq. 478, where the English cases are fully examined; Railw. Co. v. Sprague, 103 U. S. 756; Seybel v. National Currency Bank, 54 N. Y. 288; 13 Am. R. 583; Dutchess Co. Mut. Ins. Co. v. Hachfield, 1 Hun (N. Y.), 675; 47 How. Pr. (N. Y.) 330; Madison &c. R. Co. v. Norwich Saving Soc. 24 Ind. 457; New Orleans &c. R. Co. v. Mississippi College, 47 Miss. 560; Belo v. Forsythe Co. 76 N. C. 489; Grand Rapids &c. R. Co. v. Sanders, 17 Hun (N. Y.), 552; Citizens' Sav. Bank v. Greenburgh, 173 N. Y. 215; 65 N. E. 978; Brewton v. Spira, 106 Ala. 229; 17 So. 606. See Woodbury v. Allegheny &c. R. Co. 72 Fed. 371.

[110] Murray v. Lardner, 2 Wall. (U. S.) 110; Galveston R. v. Cowdrey, 11 Wall. (U. S.) 459, 478; Spence v. Mobile &c. R. Co. 79 Ala. 576, 586; 56 Am. R. 59n, quoting text.

[111] Jones Mortgages, § **834**.

It is a presumption of law that the person presenting a negotiable bond is a *bona fide* holder, and until evidence is introduced tending to negative that presumption, he is under no obligation of proving himself a *bona fide* holder.[112] If his good faith is denied by the answer, he is entitled to show by affirmative evidence that he is a *bona fide* holder.[113]

Whether there is usury or no usury in the original sale of bonds, subsequent *bona fide* holders before the bonds are due, without notice of any usury, are all entitled to share alike out of the property mortgaged to secure the entire issue. The law is opposed to usury, but it favors *bona fide* holders of negotiable paper. In protecting such innocent holders, it is serving public policy.[114]

A *bona fide* purchaser of stolen bonds, who pays full value for them in the regular course of business, before their maturity, acquires good title to them, and to such of the coupons as were not overdue at the date of his purchase. In a suit by the purchaser upon such bonds, the burden of proof that he did not acquire them in good faith is upon the defendant.[115] The fact that the real owner gave immediate notice by publication of the fact that the bonds had been stolen does not affect the title of a subsequent purchaser for value.[116] It is usual for bankers and brokers, upon receiving notice of such thefts, to retain the memorandum for the purpose of identification of the bonds, should they be presented; but there is no legal obligation upon them to do so; and if they keep such notices, the mere omission to look for them twelve months after publication is no proof of bad faith.[117]

[112] Kennicott v. Wayne County, 6 Biss. (U. S.) 138; Wickes v. Adirondack Co. 2 Hun (N. Y.), 112; North Carolina R. Co. v. Drew, 3 Woods (U. S.), 692.

[113] Macon v. Shores, 97 U. S. 272; 17 Albany Law J. 35; Reid v. Bank of Mobile, 70 Ala. 199.

[114] Weed v. Gainesville &c. R. Co. 119 Ga. 576; 46 S. E. 885.

[115] Gilbough v. Norfolk &c. R. Co. 1 Hughes (U. S.), 410; Spooner v. Holmes, 102 Mass. 503; 3 Am. R. 1491; Evertson v. Nat. Bank of Newport, 66 N. Y. 14; 23 Am. R. 18; Seybel v. Nat. Currency Bank, 2 Daly (N. Y.), 383; 54 N. Y. 288; Carpenter v. Rommel, 5 Phila. (Pa.) 34; Consolidated Ass'n v. Numa Avegno, 28 La. Ann. 552; California v. Wells, 15 Cal. 336.

[116] Seybel v. Nat. Currency Bank, 2 Daly (N. Y.), 383; 54 N. Y. 288; Murray v. Lardner, 2 Wall. (U. S.) 110.

[117] Raphael v. Bank of England, 17 C. B. 161; Vermilye v. Adams Exp. Co. 21 Wall. (U. S.) 138.

Corporate bonds issued in pursuance of a fraudulent purpose to put them in circulation without value having been paid for them are valid obligations of the company in the hands of innocent holders for value before maurity, the bonds being coupon bonds, payable to bearer and transferable by delivery.[118] And where a corporation sold all its property, taking in payment bonds from the purchaser secured by mortgage on the property conveyed, and distributed these bonds among its stockholders, the bonds became valid obligations in the hands of *bona fide* purchasers before maturity.[119]

§ 200a. **However a contract prohibited by the constitution or statutes of a state,** although negotiable in form, is not so in fact, and no ignorance or innocence on the part of the holder will make it enforceable. It is an absolute nullity. There is a distinction between such contracts and those which are merely in excess of power expressly conferred or necessarily implied.[120]

§ 201. **A purchaser of negotiable securities before maturity can recover against the maker the full amount of them,** although he may have paid less than their par value for them. Whatever may have been their original infirmity, he is not limited in his recovery upon them to the amount he paid his vendor, unless he is personally chargeable with fraud in procuring them.[121]

[118] Hebberd v. Southwestern Land &c. Co. 55 N. J. Eq. 18; 36 Atl. 122.

[119] Lebeck v. Fort Payne Bank, 115 Ala. 447; 22 So. 75; 67 Am. St. 51.

[120] Union Pac. R. Co. v. Chicago &c. R. Co. 163 U. S. 564, 581; 16 Sup. Ct. 1173; Central Trans. Co. v. Pullman &c. Car Co. 139 U. S. 24, 59; 11 Sup. Ct. 468; McCormick v. Market Nat. Bank, 165 U. S. 538; 17 Sup. Ct. 433; Northside R. Co. v. Worthington, 88 Tex. 562; 30 S. W. 1055; 53 Am. St. R.; South Texas Nat. Bank v. Lagrange Oil Mill Co. (Tex.) 40 S. W. 328; Texarkana &c. Railroad Co. v. Bemis L. Co. 67 Ark. 542; 55 S. W. 944.

[121] Cromwell v. Sac County, 96 U. S. 51, 60. "We are aware," said Mr. Justice Field, speaking for the Supreme Court of the United States, "of numerous instances in conflict with this view of the law; but we think the sounder rule, and the one in consonance with the common understanding and usage of commerce, is, that the purchaser, at whatever price, takes the benefit of the entire obligation of the maker. Public securities, and those of private corporations, are constantly fluctuating in price in the market, one day being above par and the next below it, and often passing within short periods from one half

Bona fide holders of negotiable bonds are presumed to hold them for their full value, and their title can be impaired only by specific allegations distinctly proved.[122]

The fact that a merchant has taken bonds from a railroad company in payment for goods does not of itself prevent him from being a *bona fide* holder. The goods may be as valuable to the company as money.[123] To affect the good faith of the transaction, there must be circumstances showing that the purchaser knew there was a corrupt or fraudulent motive on the part of the officer of the company in transferring the bonds. The purchaser of negotiable bonds has nothing to do with the application of the proceeds of the purchase, if he has no knowledge of any intended misapplication of them.[124]

After bonds have passed from the hands of the person to whom they were issued into the hands of *bona fide* holders, the corporation which issued them cannot set off against the bonds a claim for damages against the original holder: as, for instance, where the bonds were issued to a contractor, damages for not finishing the road in the time specified by contract cannot be set up as against *bona fide* purchasers of the bonds.[125]

§ 202. A purchaser for value of negotiable bonds after maturity is not a bona fide purchaser so that he is entitled to protection

of their nominal to their full value. Indeed, all sales of such securities are made with reference to prices current in the market, and not with reference to their par value. It would introduce, therefore, inconceivable confusion if bona fide purchasers in the market were restricted in their claims upon such securities to the sums they had paid for them. This rule in no respect impinges upon the doctrine that one who makes only a loan upon such paper, or takes it as collateral security for a precedent debt, may be limited in his recovery to the amount advanced or secured." See Chicopee Bank v. Chapin, 8 Met. (Mass.) 40; Stoddard v. Kimball, 6 Cush. (Mass.) 469; Williams v. Smith, 2 Hill (N. Y.), 301; Lay v. Wissman, 36 Iowa, 305.

Contra, Diamond v. Lawrence County, 37 Pa. St. 353.

[122] Bronson v. La Crosse &c. R. Co. 2 Wall. (U. S.) 283; Wickes v. Adirondack Co. 2 Hun (N. Y.), 112; Lehman v. Tallassee Mfg. Co. 64 Ala. 567; Morton v. New Orleans &c. R. Co. 79 Ala. 590, 621.

[123] Kennicott v. Wayne County, 6 Biss. (U. S.) 138.

[124] Philadelphia &c. R. Co. v. Lewis, 33 Pa. St. 33; 75 Am. Dec. 574.

[125] McElrath v. Pittsburgh &c. R. Co. 55 Pa. St. 189.

against the rightful owner, from whom they had been stolen, unless he has succeeded to the rights of a *bona fide* purchaser before maturity. The ownership and theft of the bonds having been proved, the burden is cast upon the purchaser to show that he is a *bona fide* purchaser, or that he has succeeded to the rights of such a purchaser. If the bonds were stolen before maturity, and, after passing through the hands of several purchasers in good faith and for value, are finally purchased after maturity in good faith and for value, in the absence of proof there is no presumption that the thief, or any holder succeeding the thief, negotiated the bonds before their dishonor.[126]

§ 203. **At what time a bond is overdue,** so that it is discredited and deprived of the immunity which it had before maturity in favor of a *bona fide* purchaser for value, depends for the most part upon its terms. It may by its terms become due upon any default in the payment of principal or interest, without any demand or notice, or it may become due after the expiration of a specified time from such default. A demand is essential to create a default where the condition of the bond is that the principal of the bond should become due if an instalment of interest due should remain unpaid for six months after a demand should be made for the payment of the same.[127]

If the terms of a bond are such that some action on the part of the bondholders or the trustees under the mortgage is necessary after a default in the payment of interest, or of a sum payable to

[126] Northampton Nat. Bank v. Kidder, 106 N. Y. 221; 12 N. E. 577; 60 Am. R. 443; Hinckley v. Merchants' Nat. Bank, 131 Mass. 147.

[127] Railway Co. v. Sprague, 103 U. S. 756; Northampton Nat. Bank v. Kidder, 106 N. Y. 221; 12 N. E. 577; 6 Am. R. 443.

A called bond is not overdue from the time it is called. Thus, a so called five-twenty government bond, which had been called for payment after the lapse of five years, and a day named for its payment, after which interest would cease, was not an overdue bond. The penalty for non-presentment for payment by the day appointed was only the loss of interest from that time. The bonds would not become overdue within the principle permitting inquiry as to title in the hands of a bona fide purchaser for value, and without notice until after the lapse of the twenty years named in the bonds for their unconditional payment. Morgan v. United States, 113 U. S. 476; 5 Sup. Ct. 588.

the sinking fund, in order to show an election on their part to consider the bonds due, an action to foreclose the mortgage based upon such a default shows such an election.[128]

§ 204. A pledgee of negotiable bonds, who is a bona fide holder for value, before maturity, is entitled to the protection of an owner, to the extent of his loan upon them.[129] A *bona fide* purchaser of bonds which a company has pledged for a loan can hold them against the company for at least the amount he has paid for them. Thus, the Grand Rapids and Indiana Railroad Company, through its president, borrowed money of its New York agents, and pledged with them the bonds of the company to a large amount as security for the loan of an inconsiderable amount. The agents, without authority, sold the bonds or exchanged them for real estate, and the first purchasers resold them. In an action by the company to recover the bonds, it was held that the amount actually paid them by the purchaser might be taken into consideration in determining his good faith.[130] At the time of the second sale there were overdue coupons upon the bonds, which provided that after six months' default the whole principal sum should immediately thereafter become due and payable. Whether this condition had the effect to make the bonds overdue it was unnecessary to decide, because the first purchaser, having bought them in good faith before maturity, could give a good title to one purchasing from him in good faith after maturity.

However, it has since been decided that unpaid coupons do not necessarily affect the purchaser with notice or knowledge of any facts

[128] Northampton Nat. Bank v. Kidder, 106 N. Y. 221; 12 N. E. 577; 60 Am. R. 443.

[129] Jones Pledges, §§ 89, 669, 670; Morton v. New Orleans &c. R. Co. 79 Ala. 590, 621; Duncomb v. New York &c. R. Co. 84 N. Y. 190; Atwood v. Shenandoah Val. R. Co. 85 Va. 966; 9 S. E. 748, citing text; Claflin v. South Carolina R. Co. 4 Hughes (U. S.), 12; Warner v. Rising &c. Iron Co. 3 Woods (U. S.), 514; Cochran v. Fox Chase Bank, 209 Pa. St. 34; 58 Atl. 117; 103 Am. St. 976n; Hayden v. Lincoln City Elec. R. Co. 43 Neb. 683; 62 N. W. 73; New Memphis Gaslight Co. Cases, 105 Tenn. 268; 60 S. W. 206; Clow v. Yount, 93 Ill. App. 112.

A purchaser from the pledgee is entitled to protection to the same extent at least. Shellenberger v. Altoona &c. R. Co. 212 Pa. St. 409; 61 Atl. 1000.

[130] Grand Rapids & I. R. Co. v. Sanders, 54 How. (N. Y.) Pr. 214.

by which the validity of the bonds was made questionable. The interest might well remain unpaid, not from any infirmity in the bonds themselves, but through want of means in the company to pay them. Under the circumstances of the case, it was determined that the last purchaser was entitled to hold the bonds for the amount he paid for them, although this amount was in excess of the sum originally borrowed by the company upon them; but that the company might recover them upon the payment of this amount.[131] The presence of due and unpaid coupons is sufficient to put the purchaser on inquiry, but they do not of themselves make the bond to which they are attached dishonored paper.[132]

§ 205. **Purchasers of bonds are not put to their inquiry whether the bonds were issued simultaneously** with the mortgage by which they are secured. There is a presumption of law that all bonds secured by a mortgage were issued at the same time, and the fact that they are numbered consecutively gives no priority to those having the earliest numbers, and in no way interferes with the equality of all holders.[133] Though the bonds are issued and sold at different dates, the whole issue is regarded as made of the date of the trust deed, regardless of the time when the bonds were actually issued.[134] The mortgage, when recorded, is notice to all who may acquire liens upon it afterwards of the debt secured. "The bonds are payable to bearer, and are intended to be negotiated for the purpose of raising money to construct the road. If the purchaser of a bond in New York, in Amsterdam, or London, is bound to inquire whether the bond in fact was executed by the company contemporaneously with the execution of the mortgage, or whether before the signing or the negotiating of the bonds liens of laborers or material-men may not have attached to the road, it is apparent that the value of these securities would be much depreciated, and all industries which depend upon the raising of means through negotiation would be paralyzed."[135]

[131] Buffalo &c. Co. v. Medina Gas Co. 162 N. Y. 67; 56 N. E. 505.

[132] Railway Co. v. Sprague, 103 U. S. 756; Cromwell v. Sac County, 96 U. S. 51.

[133] Commonwealth v. Susquehanna &c. R. Co. 122 Pa. St. 306, 321; 15 Atl. 448; Pennock v. Coe, 23 How. (U. S.) 117.

[134] Reed's App. 122 Pa. St. 565; 16 Atl. 100.

[135] Nelson v. Iowa Eastern R. Co. 8 Am. Railw. R. 82, 88, per Day, J.

Neither is a purchaser bound to inquire how much the corporation that issued them in the first instance received for them.[136]

§ 206. **But persons buying bonds directly from a corporation are bound to inquire as to the authority of the corporation** to issue and dispose of such bonds. They are bound to inform themselves not only of the extent of the powers conferred upon the corporation by its charter, but they are chargeable with notice of all charges and limitations which are recited or disclosed by the charter, or by acts of the legislature referred to in such charter. Thus, where bonds of a railroad company formed by the consolidation of other companies purported upon their face to be first mortgage bonds, but referred to a statute which required that the bonds should be used only in purchase and exchange for the bonds of a prior company, which were a charge upon the company's property, and this charge was expressly declared in the act of incorporation and consolidation, a purchaser of the new bonds was held to be affected with notice of such charge although the bonds were put upon the market with the state's indorsement, which was in effect an official certification that the lien of the prior bonds had been discharged. The acts of the officers of the state and of the new railroad company could not affect the rights of the holders of the bonds of the original companies.[137]

§ 207. **Whether restrictions bind purchasers.**—As against a *bona fide* holder of bonds it cannot be shown that the bonds were issued in violation of a restriction imposed by the charter of the corporation—such, for instance, as a restriction that the bonds shall not be sold at less than par—unless it be shown that the bonds were issued directly to the holder, or that he in some other way had notice of the restriction. If the corporation has a general power to issue bonds, persons buying them have the right to assume that all restrictions upon this power have been complied with.[138]

Bonds of a railroad company issued in the city of New York, where both the principal and interest are made payable, are not

[136] Savannah &c. R. Co. v. Lancaster, 62 Ala. 555.

[137] Spence v. Mobile &c. R. Co. 79 Ala. 576.

[138] Ellsworth v. St. Louis &c. R. Co. 98 N. Y. 553; 33 Hun (N. Y.), 7.

rendered illegal in the State of New York by provisions in the charter of the company granted by another state, even should such prohibitions render the bonds illegal in the state where the company was organized.[139]

A bondholder can enforce a statutory liability upon directors, founded upon their failure to file a prescribed annual report as to the condition of the corporation. Although the bonds are sold by a director who is in default in filing the report and cannot enforce the penalty against his co-directors, the purchaser does not stand in his shoes. The purchaser succeeds to the title of the director, but not to the penalties and disabilities consequent upon his personal nonfeasance as a director of the corporation.[140]

§ 208. **A person acquiring bonds with notice of facts showing that they had been issued for unauthorized purposes,** and were illegal and void as against the corporation which proposed to issue them, is not a *bona fide* holder for value, and stands in no better position than the person to whom they were originally issued illegally.[141]

A purchaser of bonds having knowledge of an equitable lien thereon takes them subject to such lien.[142]

If a purchaser of corporate bonds knows that an agent of the corporation is disposing of the bonds for an unauthorized purpose, he takes them at his peril.[143] But a purchaser of mortgage bonds with notice of a claim upon the property, from one without such notice, will be protected as a *bona fide* purchaser.[144]

§ 209. **Authority of officer or agent presumed.**—In the absence of notice, a purchaser of corporate bonds may presume that an officer or authorized agent of the corporation is acting within the scope

[139] Ellsworth v. St. Louis &c. R. Co. 98 N. Y. 553; 33 Hun (N. Y.), 7.

[140] Morgan v. Hedstrom, 164 N. Y. 224; 58 N. E. 26.

[141] Chicago v. Cameron, 120 Ill. 447; 11 N. E. 899; 22 Ill. App. 91; Pearce v. Madison & I. R. Co. 21 How. (U. S.) 441.

[142] Hervey v. Illinois &c. R. Co. 28 Fed. 169.

[143] Chew v. Henrietta &c. Co. 2 Fed. 5; 1 McCrary (U. S.), 222.

[144] Porter v. Pittsburgh &c. Steel Co. 7 Sup. Ct. R. 1206.

of his authority in disposing of its bonds.[145] But one who has notice that an authorized agent of a corporation is disposing of its bonds for an unauthorized purpose, purchases them at his peril.[146] A purchaser is put upon inquiry in regard to the validity and regularity of the issue of bonds when they are put upon the market for sale for a small part of their face value, by the trustee named therein, whose duty would ordinarily be confined to enforcing payment.[147]

§ 210. The certificate of the trustee is essential to the validity of bonds, each of which provides that it shall not become obligatory until authenticated by a certificate thereon duly signed by the trustee. If the bonds be stolen without such certificate, which is afterwards forged, a purchaser is bound by the condition in the bonds making the certificate essential to their delivery; and the fact that he paid value for them and bought in good faith does not avail him as against the corporation, or against another company which had assumed the payment of the outstanding bonds of the first company. The failure of the corporation whose incomplete bonds were stolen to notify the public that they had been stolen, or that they had not been issued by the company, does not constitute such negligence as would make the company liable.[148]

III. *Incomplete and Altered Bonds.*

§ 211. Bonds unissued or incomplete when put in circulation are not entitled to the privileges of negotiable paper.[149] While, as a general rule, bonds issued by a corporation, and payable to bearer,

[145] Chew v. Henrietta M. & S. Co. 2 Fed. Rep. 5; 1 McCrary, 222.

[146] Chew v. Henrietta &c. Co. 1 McCrary (U. S.), 222.

[147] Riggs v. Pennsylvania &c. R. Co. 16 Fed. 804.

[148] Maas v. M., K. & T. R. Co. 83 N. Y. 223; Guilford v. Minneapolis &c. R. Co. 48 Minn. 560; 51 N. W. 658, 31 Am. St. 694, citing text.

[149] Maas v. M., K. & T. R. Co. 83 N. Y. 223; Barnes v. Mobile & N. W. R. Co. 12 Hun (N. Y.), 126; Coddington v. Gilbert, 17 N. Y. 489; Eastern Cable Co. v. Great Western Mfg. Co. 164 Mass. 274; 41 N. E. 295; Richardson v. Green, 133 U. S. 30, 47; 10 Sup. Ct. 280.

have the qualities of negotiable instruments, and are good in the hands of *bona fide* holders for value, the rule is predicated of bonds that are duly executed, and are free from any defect by reason of any uncertainty in any essential requisite of a negotiable instrument. An uncertainty in the amount of the principal or interest of a bond deprives it of the quality of a negotiable instrument. This point is illustrated by the case of certain bonds of the Vicksburg, Shreveport and Texas Railroad Company, which were taken from the office of the company at Monroe, in the State of Louisiana, in April, 1864, at the time of a raid of the naval forces of the United States upon that town, during the war against the seceding states, and carried off by persons connected with the expedition, without the consent of the officers of the company, and afterwards put in circulation. The face of the bonds certified that the company "is indebted to John Ray, or bearer, for value received, in the sum of either two hundred and twenty-five pounds sterling, or one thousand dollars lawful money of the United States of America; namely, two hundred and twenty-five pounds sterling if the principal and interest are payable in London, and one thousand dollars lawful money of the United States of America if the principal and interest are payable in New York or New Orleans." They further declared that the president of the company is authorized to fix by his indorsement the place of payment of principal and interest of the bonds. On the back of each of the bonds was an indorsement as follows: "I hereby agree that the within bond and the interest coupons thereto attached shall be payable in ———," signed by the president. The coupons declared that the company would pay nine pounds sterling if payable in London, or forty dollars if payable in New York or New Orleans.

Upon a bill in equity to sell the road under a mortgage securing the bonds, it was claimed that the uncertainty in the amount of the bonds was cured by the signature of the president of the road to the indorsement upon the bonds, although that left the place of payment blank; and that the indorsement in this form authorized the holder to fill the blank, and thus render the amount of the bond definite and certain. But the court held that, whatever might have the effect of a delivery of the bonds in this form by the company, the bonds having been stolen, they carried no implied authority to a subsequent *bona fide* holder for value to fill the blank, and thus

perfect the bonds; and consequently the bonds were subject to all the infirmities which attached to the title to them.[150]

In case of bonds not bearing such indorsement by the president of the company, the uncertainty of the amount payable is a defect which deprives the bonds of the character of negotiability.[151]

§ 212. Bonds with the place of payment left blank are defective,[152] In an action to recover the purchase money of bonds, mentioned in the preceding section, the Court of Appeals of New York also held that they were incomplete, and therefore not within the rules which protect *bona fide* holders for value of negotiable commercial paper. A negotiable instrument must be complete and per-

[150] Jackson v. Vicksburg &c. R. Co. 2 Woods, 141; Parsons v. Jackson, 99 U. S. 434.

[151] Parsons v. Jackson, 99 U. S. 434.

[152] Ledwich v. McKim, 53 N. Y. 307, 314. The defendants contended that they, or any holder of the bonds, were authorized to fill the blank. Such authority must be either express or implied from an actual delivery for future use of the instrument, though still in its imperfect condition. "As to an express authority," said Judge Folger, "there can be no question or doubt. The implied authority is found in the fact of delivery for use. For as it is not to be presumed that the delivery for use was meant to be a nugatory and unavailing act, and as it is apparent that it would be if the instrument may not be perfected before put to use, the law implies an intention, and hence an authority, that he to whom it is thus delivered may supply all needs for making it a perfect and binding negotiable instrument. But this authority is not implied from the fact alone that the paper is in hands other than those of him who is to be bound; but from that fact, joined with this other fact, that it has been by him intrusted to those hands for the purpose and with the intent that it shall go into use and circulation. And an express authority, though it be limited, if it be exceeded by the one in whom confidence has been reposed, renders the party to the instrument liable to a bona fide holder for value, on the principle that of two, one of whom must suffer by the wrongful act of a third, it should be he who has enabled the wrongful act to be done. But there cannot be an enabling of the wrongful act unless there be assisting action of the party to the instrument who is sought to be bound, and there must be that in his conduct, in relation to the paper, which shows a parting with the possession of it for use, or with a confidence in him to whom it is delivered." But in this case, the bonds having been stolen while still in the possession of the corporation, no implication of authority to fill the blank could arise.

fect when it is issued, or there must be authority reposed in some one afterwards to supply what is needed to make it perfect. It was evident upon the face of these bonds that they were meant to have a specific place of payment, and that the kind of national money in which they were to be paid, and the amount thereof, were also to be specific, and that all of this was yet to be specified when they came into and passed out of the hands of the defendants. An exact place of payment, when a place of payment is meant to be fixed, and an exact amount to be paid, are essential parts of a negotiable instrument. These bonds were not perfect when they passed from the possession of the defendants to the plaintiff; for it was not then determined where they were to be paid, nor in what national money they were to be paid. The corporation had given power to their president to fill this blank, which power he had not exercised.

Thus, also, where bonds were stolen which were at the time incomplete, being without the seal of the company, and the certificate of the Union Trust Company, which the mortgage made requisite to their validity, and subsequently the seal and the certificate were forged and affixed to the bonds, it was held that a purchaser for value and in good faith could not recover from the company thereon, or compel the issue of other bonds in their place.[153]

§ 213. **The effect of an over-issue of bonds** under a mortgage depends largely upon the condition of the equity of redemption. If that has been incumbered by subsequent mortgages or liens, which are entered on record, the prior mortgage is good against them for only the amount that appears of record to be a lien. The company itself may be estopped to claim that the bonds issued in excess of the amount of the mortgage as recorded are not in fact secured by it; and others in privity with the company, and not having any recorded lien, may be bound by the same estoppel. The Covington and Lexington Railroad Company executed a mortgage to secure four hundred of its bonds for $1,000 each. By mistake, the company issued and sold four hundred and twenty bonds, of which one hundred and sixty were six per cent. bonds, and two hundred and sixty were seven per cent. bonds. Instead of numbering them

[153] Maas v. Missouri, K. & T. R. Co. 11 Hun (N. Y.), 8.

from 1 to 420, which would have made the mistake manifest, the company numbered each class separately from 1 to 160 and from 1 to 260. To each bond was attached a certificate showing that it was secured by mortgage, and that the amount of the bonds issued and to be issued was not to exceed $400,000. The holders of the twenty extra bonds bought them in ignorance of the over-issue. The company afterwards executed other mortgages which were recorded, and also income bonds which were not secured by any recorded instrument. The property of the company having afterwards been sold, and the proceeds being insufficient to pay all these debts, the question arose as to the rights of the holders of these twenty bonds over-issued. It was held that the company was estopped from denying that these bonds were secured by the mortgage; and that this mortgage by estoppel gave to the holders of these bonds an equitable lien, which though unrecorded, was superior to the lien of the unrecorded income bonds subsequently issued. In a contest between equities, seniority prevails; and it is immaterial that the holders of the income bonds had no notice of the over-issue and of the estoppel of the company.[154]

Where bonds were issued under the assurance that no more than ten thousand dollars of the bonds should be issued for each completed mile of road, any further issue is void and fraudulent as against the purchasers and holders of bonds to that amount purchased upon such assurance; and such bonds having been issued without consideration paid for them at the time, the holders are not entitled to share in the proceeds of a foreclosure sale of the property.[155]

§ 213a. **General creditors' right to complain of over-issue.**—Although a mortgage is for an amount exceeding the limit authorized by statute, as between the bondholders and the company, it is a lien

[154] Stephens v. Benton, 1 Duv. (Ky.) 112

[155] Union Trust Co. v. Nevada &c. R. Co. 20 Fed. 80.

All over-issued county bonds in excess of the permitted amount are illegal and void and do not bind the county, though negotiable in form. Sutro v. Rhodes, 92 Cal. 117; 28 Pac. 98. But see Farmers' Life &c. Co. v. Toledo &c. R. Co. 67 Fed. 49, as to estoppel against a railway corporation under such circumstances.

on the corporate property and is a lien on the proceeds of a sale of such property. Such being the fact, the bondholders are entitled to the money as against the company and all persons holding under to it with notice of their position. The mortgage being executed and recorded and the negotiation of the bonds being in progress, when the creditors' claim arose, they had full notice of the mortgage and must be regarded as electing to give credit subject to the mortgage. The question is not one of the power of the company to execute such a mortgage but of the rights of the company and those deriving rights from it with full notice, to set up its fraud as a defense against the victims of the fraud.[156]

§ 214. The numbering of bonds does not ordinarily give the holders of the lower numbers any preference over the holders of the higher, when there has been an over-issue of bonds beyond the amount provided for by the mortgage. All *bona fide* holders for value stand upon the same footing. The Alabama and Chattanooga Railroad Company, a corporation of the State of Alabama, was chartered to construct a road from Chattanooga, in the State of Tennessee, across the States of Georgia and Alabama to Meridian, in the State of Mississippi. An act of the legislature of Alabama[157] required the governor of the state, whenever any railroad company of the state should have finished, equipped, and completed twenty continuous miles of railroad, to indorse on the part of the state the first mortgage bonds of the railroad company to the amount of sixteen thousand dollars per mile, for the portion thus finished and completed, and to indorse the same bonds at the rate of sixteen thousand dollars per mile for each section of five miles subsequently completed and equipped. The act also applied to railroads constructed beyond the limits of the State of Alabama by any railroad company organized under the laws of the state. The act further provided that the bonds should not be indorsed by the governor until the president and chief engineer of such company, upon oath, showed that the conditions of the act had been complied with in all respects. Soon after the passing of this act the above named company conveyed to trustees,

[156] Fidelity &c. Co. v. Western Penn. &c. R. Co. 138 Pa. St. 494; 21 Atl. 21; 21 Am. St. 911; Reed's Appeal, 122 Pa. St. 565.

[157] Approved Sept. 22, 1868; R. Code of Ala. 1867, §§ 1417, 1422.

to secure its first mortgage bonds, its entire road, together with all its other property, equipments, and franchises. The mortgage recited that the bonds to be secured were to be issued at the rate of sixteen thousand dollars per mile of its road. Bonds of $1,000 each, to the number of 5,220, purporting to be secured by this mortgage, and all bearing the same date, were issued. Each bond recited on its face that it was one of a series of numbered bonds issued in accordance with the above mentioned statute, and secured by an indorsement of the State of Alabama, and by a first lien upon the entire road and property of the railroad company. Each bond also bore the indorsement of the Governor of Alabama, with the recital that the company had complied with the conditions prescribed by law upon the performance of which the governor was required to make such indorsement. Upon each bond was also indorsed a certificate signed by the trustees named in the mortgage, that the bond was one of a series of first mortgage bonds described in and secured by the mortgaged deed. Upon a subsequent default the mortgage was foreclosed, and at the sale the property was bid in by the trustees for the benefit of the bondholders.

It appears by evidence in the case, not disputed, that the length of the road from Chattanooga to Meridian was only two hundred and ninety-five miles. At the rate of sixteen thousand dollars per mile, the mortgage authorized the issue of 4,720 bonds of $1,000 each, and the governor was authorized to indorse only that number, but in fact did indorse the whole number issued, being five hundred more than was authorized. The holders of the bonds bearing the numbers higher than 4,720 applied to the court for leave to file their bonds and become sharers in the title to the property bought by the trustees. Their petition was resisted by the holders of bonds bearing lower numbers, upon two grounds: first, because the petitioners holding the high-numbered bonds were put on notice of the fact that their bonds were not secured by the mortgage; and, second, because by the very terms of the mortgage these bonds were not secured by it. But the court held that the bonds bearing the higher numbers were secured equally with those bearing the lower numbers.[158]

[158] Stanton v. Alabama &c. R. Co. 2 Woods (U. S.), 523, 528, per Woods, Circuit Judge. To the first position the court replied: "The

§ 214a. In Massachusetts there is a statutory prohibition against

power of the railroad company to issue bonds was unlimited. It could issue as many as it chose. The bonds are therefore binding upon the railroad company. Were the holders of the bonds put upon sufficient notice of the facts that bonds held by them were not secured by the mortgage? The holders of the bonds were bound to take notice of what was contained in or indorsed upon their bonds; they were bound to take notice of what was contained in their deed of mortgage, and of the laws of the state referred to in the deed of mortgage. . . . It would seem that the very bonds and mortgage which put the purchasers upon inquiry lulled and satisfied inquiry. They had the right to presume that the governor had not violated his duty; that, before he indorsed the bonds, he had on file the oath of the president and chief engineer of the railroad company that a sufficient number of miles of railroad had been completed to authorize the indorsement. Besides this, they had the statement of the president and treasurer of the railroad company on the face of the bond, and of the trustees for all the bondholders upon the back of the bond, that the bonds were secured by the mortgage. . . .

"But suppose the purchaser of bonds had ascertained the length of the road for himself by actual measurement, how would that help him to know whether his bonds were outside or inside the terms of the mortgage? The bonds all bear the same date, and fall due on the same date. Bond number one has, therefore, no advantage over any other bond, and no presumptions are to be indulged in its favor. There is no presumption of law that it was issued first or sold first. On the contrary, the presumption is that all were sold at the same time. Practically, we know that where a large number of bonds are put upon the market, the high-numbered bonds are just as likely to be sold first as the low-numbered bonds. So that if the purchaser should, before purchasing, ascertain for himself the precise length of the road, he would have no means of ascertaining whether his bonds were over-issue bonds or not. The holders of the five hundred bonds highest in number would have precisely the same ground to say that the first five hundred are over-issues, as the holders of the first five hundred have to say this of the last five hundred. I conclude, therefore, that while it is true that the mortgage limits the number of bonds to be secured thereby, and the holder of the bonds might be required to take notice of that limitation, there was nothing to put him upon notice that the limit thus fixed had been exceeded; on the contrary, that all the presumptions and all the evidence was that it had not; nor, if he had ascertained that the limit had been exceeded, was he bound to conclude, from the fact that his bonds bore the high numbers, that they were the over-issue bonds rather than others."

the issue of any bonds, certificates or obligations of any kind, which are by the terms thereof to be redeemed in numerical order or in any arbitrary order of preference without reference to the amount previously paid thereon by the holder.[159] Under this statute it was held that certain obligations issued by the "New England Home Buyers' Association" were objectionable because payments were to be made under certain circumstances to the holder of the obligation bearing the lowest number.[160]

§ 215. All the bonds secured are presumed to have been issued at the same time,[161] without reference to the numbering. To the claim made in the case last considered, that the mortgage was executed to secure sixteen bonds of $1,000 each to the mile, and no more, that no larger number of bonds could be secured by it than its terms authorized, and that when the company had issued bonds to this extent it had no power to issue a greater number to be secured by that mortgage, substantially the same reply is made: there is no way of ascertaining which are the bonds over-issued and not secured. The law presumes they were all issued at the same time, and the purchaser has the right to act on that presumption. The numbering is merely a matter of convenience in their registration and identification. Even if there were a second mortgage upon the property, in case the foreclosure sale did not produce a sum more than sufficient to pay the amount actually secured by the mortgage, no second mortgage bondholder is injured by allowing the over-issue to share in the proceeds, and no first mortgage bondholder can exclude any other from sharing in the proceeds. In case the proceeds of the foreclosure sale had exceeded the amount secured by the mortgage, and there were no subsequent incumbrance, all the bonds, being valid debts of the company, would be paid in full, or *pro rata* so far as the proceeds would go; but if there were a second mortgage, the amount for which the first mortgage was a security by its terms would be distributed *pro rata* among all the bondholders.[162]

[159] Mass. R. L. ch. 73, §§ 7, 8.

[160] Attorney General v. Pitcher, 183 Mass. 513; 67 N. E. 606.

[161] State v. Cobb, 64 Ala. 127.

[162] Stanton v. Alabama &c. R. Co. 2 Woods (U. S.), 523, 528. "The case is this," said Woods, J. "A mortgage is made to trustees to secure a given number of bonds, and, as a matter of security to the bond-

The date of the lien of a bond does not depend upon the date of its original negotiation. The entire series stands upon a footing of exact equality in this respect, the first one issued has no better or earlier lien than the last one. To give priority of lien among a series of railway bonds secured by the same mortgage, according to priority of issue, would contravene the manifest design of the maker. It would be wholly impracticable.[163]

§ 216. The alteration of the number of a negotiable bond not required by law to be numbered, inasmuch as it does not change the tenor of the bond, is immaterial; and although made with fraudulent intent, does not avoid it against a holder who takes it afterwards in good faith, for value, without notice of the alteration, or reason to suspect it.[164] Marks of such alteration, when slight only, will not discredit the bond in the market, or deprive the holder of the production of a *bona fide* holder.[165] A purchaser of such bond in open market is not bound to make a close and critical examination of it to escape the imputation of bad faith in the purchase.

holders, the trustees are required to place their certificate upon the bond to the effect that it is described in and secured by the mortgage. The common trustees of all the bondholders are unfaithful, and certify to a larger number of bonds than were intended to be secured by the mortgage. The result is, that all must suffer from the unfaithfulness of the trustees. But no part of the bondholders can say that the loss shall fall exclusively on others. It is a case for the application of the rule that equality is equity. A second mortgage bondholder would have the right to insist that the first mortgage should only secure bonds to the extent of 16,000 per mile. But no first mortgage bondholder has the right to say that he shall be paid in full to the exclusion of others whose bonds purport to be secured by the same mortgage, and whose equities are equal to his."

In Sayles v. Bates, 15 R. I. 342; 5 Atl. 497, in passing upon stockholders' liability for contribution, it was held that a bonded debt was incurred at the time when each bond was issued. So if bonds were issued at different times, portions of the debt were incurred at different times.

[163] Pittsburg &c. R. Co. v. Lynde, 55 Ohio St. 23; 44 N. E. 596.

[164] Commonwealth v. Emigrant Industrial Sav. Bank, 98 Mass. 12; 93 Am. Dec. 126; Birdsall v. Russell, 29 N. Y. 220; Elizabeth v. Force, 29 N. J. Eq. 587.

[165] Birdsall v. Russell, 29 N. Y. 220.

Even his knowledge of suspicious circumstances is immaterial, unless amounting to proof of want of good faith.[166]

IV. *Remedies upon Corporate Bonds.*

§ 217. **In an action upon a bond** issued under the provisions of a railroad act authorizing a company to borrow money and issue bonds and mortgages for the purpose of completing, furnishing, or operating its road,[167] it would seem that the plaintiff ought properly to allege that the money was borrowed for the purpose provided for, and that it was necessary for that purpose.[168]

§ 218. **An unconditional deposit of funds for the payment of bonds at the time and place where they are made payable is equivalent to a tender** of the sum payable, and if the bonds are payable

[166] Spooner v. Holmes, 102 Mass. 503; 3 Am. R. 491. "The number of the bond," say the New Jersey Court of Errors and Appeals in the latter case, "is put upon it as a mark denoting, for the convenience and protection of the maker, that it is one of a series; but such mark does not enter into or in anywise affect the agreement embodied in it; the purchaser has nothing to do with it, and need give it no heed. To lay down the broad doctrine that an alteration in such an incidental and unessential characteristic as this, by a person possessed of no legal title to the instrument, will have the effect of annulling such an instrument in the hands of a bona fide holder who has purchased and paid for it in the ordinary course of trade, would be to imperil all persons dealing in this species of property. It is very clear that the true principle should be, that the holder of a negotiable instrument should bear no risk arising from antecedent alterations of it, except with respect to such as have been made by a prior legal holder; and against the existence of any such imperfections in his title he has a sufficient guaranty in that common prudence that for the most part, deters men from doing an act destructive of their own rights; whereas, if he is to be held answerable for the acts of persons having no legal interest in the instrument, no safeguard whatever is provided in the nature of the transaction." Elizabeth v. Force, 29 N. J. Eq. 587, 591.

[167] 2 R. S. N. Y. 1875, p. 532.

[168] Miller v. N. Y. &c. R. Co. 8 Abb. (N. Y.) Pr. 431; 18 How. (N. Y.) Pr. 374. See Pettibone v. Toledo &c. R. Co. 148 Mass. 411; 19 N. E. R. 337; Eastern Cable Co. v. Great Western Mfg. Co. 164 Mass. 274; 41 N. E. 295.

or redeemable, such tender is a bar to the recovery of interest represented by coupons subsequently becoming due. As a condition of such tender and payment, the surrender of the bonds and all coupons then held by the bondholder could be rightfully demanded. At the time of tender there is owed on each bond but one debt, and that is the amount of the bond with the interest thereon. The obligor has the right to tender the payment of the entire debt, and to demand the surrender of all the securities by which it is evidenced, including past due coupons in the hands of the bondholders.[169]

An action may be maintained upon a bond payable at a fixed time and place without allegation or proof of presentation at the time and place mentioned.[170] This is the rule applicable to a suit against the maker of a note, or the acceptor of a bill of exchange. But if the maker or acceptor was at the place at the time designated, and was ready and offered to pay the money, it is matter of defense to be pleaded and proved on his part.[171]

No demand of payment at the place where the bonds are made payable is necessary when the corporation is insolvent and has no funds at the place designated. The law does not exact the performance of such a fruitless act.[172] But the insolvency of the company, and its want of funds at the place where the bonds are payable, must be alleged in the bill or admitted by demurrer.[173]

Where bonds are made payable at the company's office in a particular place, and at the maturity of the bonds the company has no office at that place, a demand of payment elsewhere is sufficient.[174]

§ 219. **Bonds illegally issued** cannot be actively enforced either in a court of law or a court of equity.[175] Yet if a corporation which has issued such bonds comes into a court of equity seeking to set them aside, equitable terms may be imposed upon it; and if the corporation has had the benefit of the sums of money for which these

[169] Bailey v. Buchanan, 115 N. Y. 297; 22 N. E. 155, reversing 22 J. & S. 237.

[170] Langston v. South Carolina R. Co. 2 S. Car. 248; First Nat. Bank v. Scott County, 14 Minn. 77.

[171] Wallace v. McConnell, 13 Pet. (U. S.) 136.

[172] Shaw v. Bill, 95 U. S. 10.

[173] Potomac Mfg. Co. v. Evans (Va.), 6 S. E. 2.

[174] Alexander v. Atlantic &c. R. Co. 67 N. C. 198.

[175] McKee v. Grand Rapids &c. R. Co. 41 Mich. 274; 1 N. W. 873; 50 N. W. 469.

invalid bonds had been given, it may be charged as a debtor to that extent.[176] But, as already noticed, corporations may be estopped by their acts from claiming the invalidity of their bonds; and if the bonds be negotiable, purchasers for value may not be affected by their irregular or illegal issue.[177] The invalidity of some of the bonds secured by a mortgage does not affect the validity of the mortgage or of the other bonds, or of the proceedings to foreclose the mortgage.[178]

Under a statute in New Jersey that bonds of a railway corporation should not be issued in excess of the capital stock actually paid in, it was held that the over-issue was invalid in the hands of one who was a director at the time of the over-issue.[179]

§ 219a. Relief in equity for misapplication of proceeds of bond sale.—Under a covenant in a mortgage securing a bond issue to devote the bonds or their proceeds to the improvement of the mortgaged property and to enhance the security of the mortgage lien, one who purchases in the open market with full knowledge of the situation and how the bonds or their proceeds have been used, cannot enforce the covenant. He does not act upon the faith of any statement in the mortgage, but upon his own judgment. A person cannot buy depreciated securities in the market, with knowledge of all the facts, and then proceed to increase the value by attacking in a court of equity, business transactions which took place years before. It is the absence of any commanding equity in his favor, not any inherent infirmity that attaches to the bonds themselves, that constitutes the conclusive answer to such an action.[179a]

The transfer of about $70,000 worth of coal lands in payment of $5,000,000 stock subscription in a corporation is, in the absence of any explanation, such an apparent over-valuation of the property as to be fraudulent. Under such circumstances the identity of

[176] Cork & Y. R. Co. In re, L. R. 4 Ch. App. 748; Durham County &c. Building Soc. In re, L. R. 12 Eq. 516, 521; Grand Junction R. Co. v. Bickford, 23 Grant's Ch. (Ontario) 302; Hinckley v. Pfister, 83 Wis. 64; 53 N. W. 21, citing text.

[177] See § 200.

[178] Graham v. Boston &c. R. Co. 118 U. S. 161; 6 Sup. Ct. 1009.

[179] Steelman v. Baker, 53 N. J. Eq. 672; 33 Atl. 815.

[179a] Belden v. Burke, 147 N. Y. 542; 42 N. E. 261, reversing 72 Hun (N. Y.), 51; 25 N. Y. S. 601.

a substantial portion of the bondholders with the original stockholders of the company being determined, the conclusion is inevitable that in equity and conscience the lien of the mortgage should be postponed in favor of general creditors having *bona fide* claims. The issue of bonds was one act in a fraudulent design to secure the stockholders from possible loss.[180]

§ 220. Relief may be had in equity for the loss or destruction of negotiable bonds and coupons. The jurisdiction of the court for this purpose will be exercised, and relief granted by ordering the issue of other bonds in place of those lost, whenever the loss or the destruction of the instruments has happened without the negligence or fault of the party applying, provided such relief can be given without derogating from any positive agreement, or violating any equal or superior equity in other parties. Such relief was granted in the case of bonds stolen at the time of the evacuation of Petersburg by the Confederate forces, the bonds having been hidden in the ground for safety;[181] and in like manner in the case of bonds stolen from the vault of a banking company.[182] It has been insisted sometimes that there is no relief in equity when the loss has occurred through theft. But equity makes no distinction in this respect.[183]

In case the lost or destroyed bonds have considerable time yet to run before maturity, it is within the power of a court of equity to grant relief by decreeing a reissue of the bonds, upon the execution of a good and sufficient bond of indemnity to the company against the claims of *bona fide* holders of the bonds alleged to be lost.[184] To enjoin the company from paying the bonds to any *bona fide* holder is useless and erroneous.[185]

[180] Manhattan Trust Co. v. Seattle Coal &c. Co. 16 Wash. 499; 48 Pac. 333, 731.

[181] Chesapeake &c. Co. v. Blair, 45 Md. 102. See § 327.

[182] Force v. Elizabeth, 27 N. J. Eq. 408.

[183] Force v. Elizabeth, 27 N. J. Eq. 408.

[184] Rogers v. Chicago &c. R. Co. 6 Abb. N. C. (N. Y.) 253.

[185] New Orleans &c. R. Co. v. Miss. College, 47 Miss. 560.

In an action of law on a bond it was left to the jury on the evidence to decide whether the bonds did belong to the plaintiff's testator, or to the mortgagor corporation, there being unusual circumstances in the case. Philadelphia Trust Co. v. Philadelphia &c. R. Co. 160 Pa. St. 590; 28 Atl. 960.

§ 220a. Liability of seller of bonds rests on fraud.—One who has in good faith sold bonds of a private or municipal corporation which are for any reason void is not liable to the purchaser for the price paid for them, unless he has warranted their validity.[186] He is liable *ex delicto* for bad faith; and *ex contractu* there is an implied warranty on his part that they belong to him, and that they are not forgeries. Where there is no express stipulation, there is no liability beyond this. If the buyer desires special protection, he must take a guaranty.[187]

One who induces another to purchase bonds by false representations regarding the security is liable to such purchaser in an action of tort for deceit. Interest may be paid for years on bonds of a corporation and yet one who has purchased them at par may be grossly defrauded in the purchase and a party who has been induced by fraud to purchase bonds that have no substantial or adequate security behind them may have redress for the fraud without waiting for the inevitable day when default will be made. The mere payment of interest does not show that a debt is secured. The damage that a purchaser of such securities suffers is capable of being ascertained when he learns of the true condition of the corporation and the property upon which the mortgage bonds are liens. The prompt payment of high interest is no sign that the security is good, at least no conclusive proof.[188]

Sellers of bonds are bound to practice no concealments towards a purchaser and to give him all desired information in regard to their relation to the company, but this is an obligation to each person with whom they deal and the rights of their several vendees are several and according to the nature of the particular transaction, and cannot be collectively asserted in a suit by the receiver of the company. The ground of liability is concealment or misrepresentation by those whose duty it is, by virtue of their relation to the

The Alabama statute authorizing a suit at law on a bond which has been lost or destroyed by accident applies to the loss of a bond by theft. The affidavit stating the loss of the bond is not admissible as evidence in case a verified answer is filed denying the execution of the instrument. Mobile County v. Sands, 127 Ala. 493; 29 So. 26.

[186] Otis v. Cullum, 92 U. S. 447.

[187] Per Swayne, J., in Otis v. Cullum, 92 U. S. 447.

[188] Currier v. Poor, 155 N. Y. 344; 49 N. E. 937, reversing 84 Hun (N. Y.), 45; 32 N. Y. S. 74.

other persons interested in the transaction, to make a full disclosure.[189]

On who in good faith secures a purchaser for an invalid bond, is entitled to the agreed commission although the sale fails to go through because of the invalidity of the bond, but if he knew of the defect at the time he negotiated the sale, he is not entitled to recover.[190].

A statement that bonds will be paid whether or no refers merely to their being a legal obligation on the corporation and will not support an action for deceit if the security prove insufficient.[191]

§ 221. A right of conversion into stock can be enforced only by the holder of the bond. When bonds of a railway company, payable to the holder and assignable by delivery, are made convertible into the capital stock of the company at the pleasure of the holder, at par, the right of conversion goes with the bonds and is inseparable from them. The right of conversion is available to the holder only so long as he continues the holder, when it passes by the transfer of the bonds to the new holder. Upon the refusal of the company to make the conversion upon the demand of a holder, he has several courses open to him at his election. He may waive the right thus denied him, continue to draw his interest as it accrues, and demand the principal at maturity; or may at any time renew his demand; or he may divest himself of all interest in the subject matter, and invest another party with all his rights, including the right of election as to the mode of performing the contract, by a sale and transfer of the bond; or he may stand upon and abide by the election and demand already made, and on his right to convert the bond into capital stock; and may by action recover, by way of damages for the breach of contract, the full market value of the stock wrongfully withheld from him. Such recovery would be a bar to any further suit on the bond, and the payment of the judgment would place the company in the legal position they would be in had they issued the stock on demand.[192] But in an action

[189] Tompkins v. Sperry, 96 Md. 560; 54 Atl. 254.

[190] Berg v. San Antonio &c. R. Co. 17 Tex. Civ. App. 291; 42 S. W. 647; 43 S. W. 929.

[191] Kimber v. Young, 137 Fed. 744.

[192] Per Scott, C. J., in Denney v. Cleveland &c. R. Co. 28 Ohio St. 108, 110. The convertible clause in this case was indorsed upon the

for the refusal to convert the bonds into stock, it is clear that the plaintiff must allege not only his ownership at the time of the demand for conversion, and that he then offered to surrender the bonds for concellation, but also that he is still the owner and holder of such bonds, and now brings them into court for cancellation, upon his recovery of damages for breach of the stipulation; and an action without such allegations is fatally defective.

An option given in a railroad bond to convert it into stock within a specified time must be exercised within that time or it is forever gone, and can only be renewed, or the right to exercise it revived by a new contract. An agreement for the extension of the time of payment of the bond cannot have that effect.[193]

A bondholder having the privilege of converting bonds into stock of the company cannot be deprived of this privilege by the consolidation of the company with another company, until he has had a fair opportunity, after notice of the contemplated change, to exercise the original rights, and has elected not to do so.[194]

§ 221a. A by-law authorizing bondholders to vote for directors is invalid when it is in conflict with constitutional and statutory provisions requiring the directors to be stockholders and elected at the annual meeting of the stockholders. The argument that the purchasers of stock takes it and holds it subject to the right of the bondholders to vote is answered by the fact that the rights of the stockholder to vote is declared in the public acts of the state. It is for the interest of the public that railway companies be successfully managed. The interest of the shareholders depends upon the success of the corporation, while the interest of the bondholders frequently lies in the depreciation of value and revenues, with a view to foreclosure and future ownership.[195]

bonds, over the signature of the president of the company, in the following terms: "The within bond, convertible into the capital stock of the company at the pleasure of the holder, at par, upon the surrender thereof, with the unpaid interest coupons, to the secretary of the company. By order of the directors." Denney v. Cleveland &c. R. Co. 28 Ohio St. 108, 110.

[193] Muhlenberg v. Philadelphia &c. R. Co. 47 Pa. St. 16.

[194] Rosenkrans v. Lafayette &c. R. Co. 18 Fed. 513.

[195] Durkee v. People, 155 Ill. 354; 40 N. E. 626; 46 Am. St. 340; 52 Ill. App. 396.

§ 222. Bonds issued by a railroad company in the hands of a non-resident of a state are not subject to taxation by that state. The bonds are property in the hands of the holders, and when held by non-residents they are properly beyond the jurisdiction of the state. A statute requiring the treasurer of the company to retain a percentage of the interest due to the non-resident bondholders is not, therefore, a legitimate exercise of the taxing power. It is a law which interferes between the company and the bondholder, and under the pretence of levying a tax commands the company to withhold a portion of the stipulated interest and pay it over to the state. It is a law which impairs the obligation of the contract between the parties. The fact that the bonds are secured by a mortgage of property situated in the state does not confer any right to tax such bonds. The mortgage is a mere lien, and though in the form of a conveyance confers no absolute ownership. The mortgagee has a chattel interest which follows the person of the owner.[196]

The constitutional provision against impairing the obligations of contracts is a limitation upon the taxing power of a state as well as upon other legislation; and in fact this provision is more frequently violated in exercise of the taxing power than in any other mode. "No state," says Mr. Justice Strong,[197] "by virtue of its taxing power, can say to a debtor, 'You need not pay to your creditor all of what you have promised to him. You may satisfy your duty to him by retaining a part for yourself, or for some municipality, or for the state treasury.' Much less can a city say, 'We will tax our debt to you, and in virtue of the tax withhold a part for our own use.'" No municipality of a state can, by its own ordinances, under the guise of taxation, relieve itself from performing to the letter all that it has expressly promised to its creditors.[198]

A state has no power to tax the bonds of a railroad corporation whose road lies partially in two or more states, when the bonds are

[196] Case of the State Tax on Foreign-held Bonds, Railroad Co. v. Pennsylvania, 15 Wall. (U. S.) 300; Railroad Co. v. Jackson, 7 Wall. (U. S.) 262; Davenport v. Miss. &c. R. Co. 12 Iowa, 539; People v. Eastman, 25 Cal. 601, 603; Commonwealth v. Chesapeake &c. R. Co. 27 Gratt. (Va.) 344. Contra, see Maltby v. Reading &c. R. Co. 52 Pa. St. 140.

[197] Murray v. Charleston, 96 U. S. 432.

[198] Murray v. Charleston, 96 U. S. 432.

binding upon every part of the road.[199] If one state can tax the bonds, the other can also tax them, and thus there would be a double taxation of the same property; or, if the road extends through five or six states, there might be a taxation of the same property five or six times over. A state cannot properly impose a tax upon property and interests lying beyond her jurisdiction.

Railroad charters sometimes contain an exemption from taxation, either total or limited; and in such case the exemption is irrepealable and inviolable.[200]

§ 223. A bondholder cannot enforce in his own name a contract made by the association that made the bonds with another party. Thus, an association having issued bonds, a corporation agreed to assume the payment of the bonds, provided that the association would issue stock to the corporation to the amount of the bonds assumed and paid: it was held that a bondholder was not in such privity with the corporation, nor had he such an interest in the contract between it and the association as to warrant a suit in his own name to compel the corporation to pay the bonds.[201]

[199] Railroad Co. v. Jackson, 7 Wall. (U. S.) 262.

[200] Mobile &c. R. Co. v. Moseley, 52 Miss. 127. See Livingston County v. Hannibal &c. R. Co. 60 Mo. 516.

[201] National Bank v. Grand Lodge, 98 U. S. 123.

CHAPTER VII.

PROMISSORY NOTES AND UNSECURED BONDS OF CORPORATIONS.

I. Promissory notes of corporations, §§ 224–229.

II. Unsecured bonds of corporations, §§ 230–234.

I. *Promissory Notes of Corporations.*

§ 224. Corporations, except as restrained by express provisions, or by necessary implications, may use any form of security, or any kind of acknowledgment of indebtedness that an individual may use.[1] A note, signed by the proper officers, and with the seal of the corporation attached, is itself *prima facie* evidence of the authority of the officers and of its due execution by them.[2]

Where the nature and character of the business of a corporation warrant the use of ordinary negotiable instruments, such as promissory notes and bills of exchange, the company has an implied authority to issue them. In the United States this implied authority is held to belong to all ordinary commercial corporations, when used for proper corporate purposes[3] yet in England the courts have at

[1] Pusey v. New Jersey &c. R. Co. 14 Abb. Pr. N. S. (N. Y.) 434.

[2] Mills v. Boyle Min. Co. 132 Cal. 95; 64 Pac. 122.

[3] Moss v. Averell, 10 N. Y. 449, 457; Olcott v. Tioga R. Co. 27 N. Y. 46. "No question is better settled upon authority than that a corporation, not prohibited by law from doing so, and without any express power in its charter for that purpose, may make a negotiable promissory note, payable either at a future day or upon demand, when such note is given for any of the legitimate purposes for which the company was incorporated." The American courts have fully estab-

different times denied the power to almost all corporations,[4] except those whose business is banking, or some kind of financial enterprise which necessarily involves the making or negotiating of negotiable instruments.[5] In some cases where such a power cannot be inferred from the nature of the business, it is conferred by implication from the general words of the charter or the articles of association.[6] Thus the memorandum of association of a company formed for the purpose of purchasing a concession from the government of Peru for the construction of a railway contained the provision, that "in order to the attainment of the main object of the company they may do, either in the United Kingdom or Peru, or elsewhere, whatsoever they from time to time think incidental or conducive thereto." It was held that this language was wide enough to authorize the company to make negotiable instruments. "It is, I think," said Lord Cairns, L. J., "beyond all possibility of dispute, that, if they think it incidental or conducive to the attainment of the concession, when the instalments become or are about to fall due, in place of making calls on their shareholders, they should give a bill of exchange, payable at a future day, for the amount of the instalments, they may do so."[7]

If a note of a corporation was expressly authorized at a meeting of the board of directors, it will be presumed that the board was rightfully in session at the time.[8]

lished this principle, and from general considerations of policy and of law it must be regarded as correct. Barker v. Mechanic &c. Ins. Co. 3 Wend. (N. Y.) 94; Clark v. Farmers' Woolen Mfg. Co. 15 N. Y. 256; Smith v. Eureka Flour Mills Co. 6 Cal. 1; Richmond &c. R. Co. v. Snead, 19 Gratt. (Va.) 354; Buck v. Troy Aqueduct Co. 76 Vt. 75; 56 Atl. 285; Andres v. Morgan, 62 Ohio St. 236; 56 N. E. 875.

[4] Bateman v. Mid-Wales R. Co. L. R. 1 C. P. 499; Peruvian R. Co. v. Thames &c. Ins. Co. L. R. 2 Ch. 617; Broughton v. Manchester &c. Works Co. 3 B. & A. 1; East London W. Works Co. v. Bailey, 4 Bing. 283; Dickinson v. Valpy, 10 B. & C. 128; Burmester v. Norris, 6 Ex. 796; Steele v. Harmer, 14 M. & W. 831; 4 Ex. 1; Bramah v. Roberts, 3 Bing. N. C. 963; Thompson v. Universal Salvage Co. 1 Ex. 694.

See, however, Moseley Green Coal &c. Co. In re, 4 De G., J. & S. 756.

[5] General Estates Co. In re, L. R. 3 Ch. 758, 761; Land Credit Co. of Ireland, In re, L. R. 4 Ch. 460.

[6] Peruvian R. Co. v. Thames &c. Ins. Co. L. R. 2 Ch. 617, 624.

[7] Peruvian R. Co. v. Thames &c. Ins. Co. supra. L. R. 2 Ch. 617, 624.

[8] Hardin v. Iowa R. &c. Co. 78 Iowa, 726; 43 N. W. 543. In this

§ 225. **The English decisions are not altogether uniform in this matter,** for while there are a few decisions which really rest upon the principle that a corporation may make such ordinary negotiable paper as is incidental to the nature of its business,[9] yet the cases generally are the other way.[10]

There is no question, however, that corporations of all kinds may draw checks in the usual course of business. This power is necessary for every corporation, and being necessary, is implied.[11]

A distinction is taken between bills and notes, by a corporation having no power to borrow, given in its ordinary business, as, for instance, in the purchase of property essential for its use, and bills and notes given for actual loans of money. In like manner, an existing debt may be paid by means of bills of exchange, when the debt could not be created originally in that way.[12] "Borrowing and

case it was further held that, under authority given the officers of a corporation to execute a note for a certain sum at a given rate of interest, the officers have no power to stipulate for the payment of attorneys' fees in the event of a suit to collect such note.

[9] Moseley Green Coal &c. Co. In re, 4 De G., J. & S. 756; Peruvian R. Co. v. Thames &c. Ins. Co. supra.

[10] Thus, in Bateman v. Mid-Wales R. Co. L. R. 1, C. P. 499, 509, the question was whether a railway company could lawfully bind itself by accepting a bill of exchange. Erle, C. J., delivering the judgment, said: "I am of opinion it cannot. The bill of exchange is a cause of action, a contract by itself, which binds the acceptor in the hands of any indorsee for value: and I conceive it would be altogether contrary to the principles of the law which regulates such instruments that any should be valid or not, according as the consideration between the original parties was good or bad, or whether, in the case of a corporation, the consideration in respect of which the acceptance is given is sufficiently connected with the purposes for which the acceptors are incorporated. It would be inconvenient to the last degree if such an inquiry could be gone into. Some bills might be given for a consideration which was valid, as for work done for the company, and others as a security for money obtained on loan beyond their borrowing powers. It would be a pernicious thing to hold that, in respect to the former, the corporation might be sued by an indorsee, but in respect of the latter not."

[11] Waterlow v. Sharp, L. R. 8 Eq. 501; Serrell v. Derbyshire &c. R. Co. 9 C. B. 811. See Davis v. Rockingham, Ins. Co. 89 Va. 290; 15 S. E. 547.

[12] Cefn Cilcen Mining Co. In re, L. R. 7 Eq. 88; and see Waterlow v. Sharp, L. R. 8 Eq. 501.

lending," says Stuart, V. C., "are things perfectly well understood, and although the procuring of money by means of a bill of exchange confers the same benefit on the person who procures it as if he were to borrow the amount, yet it is impossible to consider transactions upon bills of exchange given in this manner as borrowing and lending within the meaning of the company's articles of association. It has been well decided that a balance due a bank by a company which keeps an account with it, and has had the benefit of the money, is a debt, but not a loan in the proper sense."

§ 225a. As a general rule no managing agent of a corporation, except the cashier of a bank, possesses implied power to bind it by issuing negotiable instruments in its behalf.[13] This is to protect the corporation from the fraud of its agents, because such paper, in the hands of an innocent holder, is subject practically to no defence.[14] Though the corporation be given power to issue notes, the authority of the officers to execute them could only be derived from a by-law or from a resolution of the board of directors.[15]

Because of this rule the president of a corporation has no implied power to bind the corporation by his signature to commercial paper, and this power is not presumptively greater in the president and secretary. Proof that a promissory note is signed by the president and secretary of a corporation does not shift the burden of proof upon the defendant in an action on the note.[16]

The law knows nothing of such an officer as the "business manager" of a corporation, and courts will not presume anything in regard to his authority to execute promissory notes in behalf of the corporation; but an allegation in the pleadings that the notes were made, executed, and delivered by the corporation, is sufficient.[17] Where under a by-law the president, vice-president, and treasurer are to form a business committee, such committee does not have power

[13] 2 Cook Corp. (5th Ed.) § 719; Elwell v. Puget Sound &c. R. Co. 7 Wash. 487; 35 Pac. 376; Third Nat. Bank v. Laboringman's &c. Co. 56 W. Va. 446; 49 S. E. 544.

[14] Baines v. Coos Bay Navigation Co. 45 Or. 307; 77 Pac. 400.

[15] Crawford v. Albany Ice Co. 36 Or. 535; 60 Pac. 14.

[16] Gould v. W. J. Gould & Co. 134 Mich. 515; 96 N. W. 576; 104 Am. St. 624.

[17] Topeka Capital Co. v. Remington Paper Co. 61 Kans. 6; 59 Pac. 1062.

to issue promissory notes without express authority; and the rule protecting innocent purchasers of negotiable paper against antecedent equities does not apply to the authority to make the paper, except where the agent acts within the apparent scope of his authority.[18]

But where directors vote "that the president have full power and control of all the business of the company," he has sufficient authority to issue promissory notes in payment of corporate indebtedness.[19] The officer of a construction company having full control of the building of a railroad, is authorized, in the absence of contrary instructions, to pay off its indebtedness with promissory notes.[20] So, too, where the general manager of a corporation owns practically all its capital stock and is virtually the corporation itself, the validity of promissory notes executed by him in its behalf to evidence *bona fide* corporate debts has been upheld.[21]

An officer having entire control of the business of a corporation has power to accept drafts, and his acceptance in the corporate name of a draft drawn on him personally binds the corporation and authorizes payment out of corporate funds.[22]

§ 225b. The idea that every time a person deals with an officer of a corporation, or person assuming to act in its behalf, he must under all circumstances take his chances as to whether such officer or person has been specially authorized in regard to the matter, has no place in the law of our day. Proof of apparent authority of a corporate officer to contract in its behalf *prima facie* establishes actually authority so to do, and evidence of want of such authority will not relieve the corporation from the burden of a contract made

[18] Chemical Nat. Bank v. Wagner, 93 Ky. 525; 20 S. W. 535; 40 Am. St. 206.

[19] Castle v. Belfast Foundry Co. 72 Me. 167; Hiawatha I. Co. v. John Strange P. Co. 106 Wis. 111; 81 N. W. 1034.

[20] Fitzgerald &c. Const. Co. v. Fitzgerald, 137 U. S. 98; 11 Sup. Ct. 36.

[21] Africa v. Duluth News P. Co. 82 Minn. 283; 84 N. W. 1019; 83 Am. St. 424; Baines v. Coos Bay Navigation Co. 45 Or. 307; Atlantic &c. R. Co. v. Reisner, 18 Kan. 458; Witter v. Grand Rapids &c. Mill Co. 78 Wis. 543; 47 N. W. 729.

[22] McLaren v. First Nat. Bank, 76 Wis. 259; 45 N. W. 223.

with reasonable reliance upon such apparent authority, if such corporation is responsible for such appearance.[23]

Where the president of a railway corporation has been in the habit of signing his name to notes of the company, without the express authority of the board of directors, of which custom the board is cognizant, the company will be bound by a note so executed the same as if express power to sign had been conferred. In the case where this decision was reached the practice of the president had been brought to the directors' attention, and was discussed at their meetings, but no formal action had been taken, and the president had continued to exercise such authority for years. The board of directors was held under these circumstances to have acquiesced in the acts of the president.[24] Where the president of a company is authorized to buy on credit, he can give the promissory note of the company in payment, without a resolution of the board of directors.[25]

§ 226. Accommodation paper.—As a corollary to the proposition that a corporation may make negotiable paper, it follows that such paper, though made for accommodation, is binding upon the maker in the hands of a holder in good faith for value. It may not

[23] Bullen v. Milwaukee Trading Co. 109 Wis. 41; 85 N. W. 115; Sparks v. Dispatch Trans. Co. 104 Mo. 531; 15 S. W. 417; Dexter Sav. Bank v. Friend, 90 Fed. 703; Schreyer v. Bailey & Co. 97 App. Div. (N. Y.) 185; 89 N. Y. S. 870.

[24] Elwell v. Puget Sound &c. R. Co. 7 Wash. 487; 35 Pac. 376; Duggan v. Pacific Broom Co. 6 Wash. 593; 34 Pac. 157; 36 Am. Sup. 82; Texarkana &c. R. Co. v. Bemis L. Co. 67 Ark. 542; 55 S. W. 944; Trapp v. Fidelity Nat. Bank, 101 Ky. 485; 41 S. W. 577; Cadillac Bank v. Cadillac Stave Co. 129 Mich. 15; 88 N. W. 67. In Arkansas the president and secretary of a corporation have no inherent power to execute negotiable notes in its name, nor will their authority be presumed from the mere fact that they have executed them. A usage to be good, and of which the courts will take judicial notice, must be general, and of such long standing as to have become part of the law itself. City Elec. &c. R. Co. v. First Nat. Exch. Bank, 62 Ark. 33; 34 S. W. 89; 31 L. R. A. 535; 54 Am. St. 282. The authority of officers of a corporation to give a judgment note may be shown by a general practice of giving such notes and long acquiescence by the board of directors. Burch v. West, 134 Ill. 258; 25 N. E. 658.

[25] Siebe v. Joshua Hendy &c. Works, 86 Cal. 390; 25 Pac. 14.

be within the scope of the corporate powers to make accommodation paper; but having a general power to make negotiable paper, the doctrine of *ultra vires* does not apply when in a particular case a corporation abuses this general power, and issues accommodation paper which comes into the hands of a holder for value without knowledge of such abuse.[25] The corporation is estopped from setting up the defence of *ultra vires* in such case, because it has virtually represented that the paper was given for some legitimate purpose, and having the general power to give negotiable paper, a purchaser cannot be presumed to know that any particular obligation was given for an unauthorized purpose.[27]

Under the statutory law of Texas a corporation note known by both payer and payee to be accommodation paper is an *ultra vires* contract and absolutely void.[28] But the Arkansas court allowed a recovery on such a note when the payee did not know it was an accommodation paper.[29]

It is beyond the power of an ordinary manufacturing corporation to indorse for accommodation, and one taking with notice cannot hold the corporation on such indorsement.[30]

[26] Monument Nat. Bank v. Golbe Works, 101 Mass. 57; 3 Am. R. 322; San Bernardino Nat. Bank v. Colton L. & W. Co. 91 Cal. 124; 27 Pac. 538; Consol. Perfume Co. v. Nat. Bank, 86 Ill. App. 642. See, also, Farmers' &c. Bank v. Empire &c. Dressing Co. 5 Bosw. (N. Y.) 275; Maitland v. Citizens' Nat. Bank, 40 Md. 540; 17 Am. R. 620; Bank of Genesee v. Patchin Bank, 13 N. Y. 309; Mechanics' Banking Association v. New York &c. Lead Co. 35 N. Y. 505; Central Bank v. Empire Stone &c. Co. 26 Barb. (N. Y.) 23; Morford v. Farmers' Bank (N. Y.), 568; Bridgeport City Bank v. Empire &c. Dressing Co. 30 Barb. (N. Y.) 421; Olcott v. Tioga R. Co. 27 N. Y. 546; 84 Am. Dec. 298; Stark Bank v. United States Pottery Co. 34 Vt. 144; Smead v. Indianapolis &c. R. Co. 11 Ind. 104; Stewart v. Gould, 8 Wash. 367; 36 Pac. 443; American Trust &c. Bank v. Gluck, 68 Minn. 129; 70 N. W. 1085; Hiawatha I. Co. v. John Strange P. Co. 106 Wis. 111; 81 N. W. 1034.

[27] Bissell v. Michigan &c. R. Co.'s, 22 N. Y. 258, 289, 290, per Selden, J.; Lexington v. Butler, 14 Wall. (U. S.) 282.

[28] Const. Texas, art. 12, § 6, Rev. St. Texas 1895 art. 665, 4486.

[29] Texarkana &c. R. Co. v. Bemis L. Co. 67 Ark. 542; 55 S. W. 944.

[30] Carney v. Duniway, 35 Or. 131; 57 Pac. 192; 58 Pac. 105; M. V. Monarch Co. v. Farmers' &c. Bank, 105 Ky. 430; 49 S. W. 317; 88 Am. St. 310; Preston v. Northwestern Cereal Co. 67 Neb. 45; 93 N. W. 136; Ewards v. Carson Water Co.

A corporation note executed by the president of the company and payable to his own order is *prima facie* void. It is seemingly for his own accommodation, and thus bears on its face evidence of its invalidity. The president cannot, by virtue of his general authority as agent, bind the corporation in a contract made by him as such agent with himself; he has no authority, unless expressly given, to bind the corporation by negotiable paper which apparently was issued for his own use and benefit. Notice of this want of authority is found in the instrument itself.[31] On the same principle a person receiving a note which bears the indorsement of a corporation not in the chain of title, is charged with notice that the indorsement is for accommodation.[32]

§ 227. Paper given for the prosecution of an unauthorized business, or improperly executed.—The same reasoning applies as well to obligations given by a corporation for money borrowed to enable it to prosecute a business which it had no power to engage in. The corporation having the general power to borrow money, it would be pressing the doctrine of *ultra vires* to an extent not to be tolerated, to allow it to evade the payment of the money on the ground that it expended the money in prosecuting an unauthorized business, even though the lender knew the money would be so expended, provided the business itself be free from any intrinsic immorality or illegality.[33]

21 Nev. 469; 31 Pac. 381; Triplett v. Fauver, 103 Va. 123; 48 S. E. 875; Pelton v. Spider Lake S. &c. Co. 117 Wis. 569; 94 N. W. 293; 98 Am. St. 946. Nothing but the most unequivocal language could justify the holding that it was the intention of the stockholders to confer upon the corporation the general power, to be exercised by the president, to indorse for mere accommodation. Steiner v. Steiner, L. & L. Co. 120 Ala. 128; 26 So. 494. But in Martin v. Manufacturing Co. 122 N. Y. 165; 25 N. E. 303, it was held that an accommodation indorsement made by a corporation with the knowledge and assent of all its directors and stockholders is valid and enforceable. Prospect W. Mills, In re, 126 Fed. 1011.

[31] Porter v. Winona &c. Co. 78 Minn. 210; 80 N. W. 965; Saylor v. Commonwealth Banking Co. 38 Or. 204; 62 Pac. 652.

[32] Pelton v. Spider Lake &c. Co. 117 Wis. 569; 94 N. W. 293; 98 Am. St. 946. See Morris v. Griffith &c. Co. 69 Fed. 131.

[33] Bradley v. Ballard, 55 Ill. 413; 8 Am. R. 656; Solomon Solar Salt Co. v. Barber, 58 Kans. 419; 49 Pac. 524.

A corporation having issued a note, duly signed by its president and treasurer, and having received money upon it, cannot repudiate it because the approval of the company's executive committee did not appear upon the note, as required by a by-law. The by-law was directory to the manager, and was for the obvious purpose of restraining him from borrowing money without the approval of the committee, and not to render the note invalid in the hands of a holder without notice, for value.[34] But, on the other hand, it has been held that promissory notes of a corporation, not properly countersigned by its president, could not be enforced against the company; it further appearing that the proceeds of the notes were not used for corporate purposes, but were fraudulently misappropriated by the president and treasurer.[35]

§ 228. Of course if the holder has notice that the instrument was improperly issued by the corporation, he cannot enforce it; and such notice may be either actual or constructive. A limitation in the power of the corporation in respect to issuing a security, imposed by statute or by the charter of the company, must be taken notice of by every person dealing with it. In the leading English case upon this subject, Cockburn, C. J., delivering the judgment,

[34] Lyndon Savings Bank v. International Trust Co. 75 Vt. 224; 54 Atl. 191. Where a by-law required all contracts and agreements to be signed by the president and all orders drawn on the treasurer to be countersigned by the secretary, a promissory note was held valid without a countersignature. Peatman v. Light, Heat & Power Co. 100 Iowa, 245; 69 N. W. 541.

[35] Millward-Cliff-Cracker Co.'s Estate, 161 Pa. St. 157; 28 Atl. 1072. If the officer executing a note was duly appointed according to the records of the corporation, it cannot set up that its records were false. Barrell v. Lake View Land Co. 122 Cal. 129; 54 Pac. 594. A corporation cannot avail itself of the defence of a material alteration in a note made by its agent before delivery to the payee. Pelton v. San Jacinto Lumber Co. 113 Cal. 21; 45 Pac. 12. Notes executed by its secretary who is not clothed with general powers to execute promissory notes do not bind the corporation. Pauly v. Pauly, 107 Cal. 8; 40 Pac. 29; 48 Am. St. 98; Thompson v. Des Moines Driving Park, 112 Iowa, 628; 84 N. W. 678. Corporate notes executed by directors to a bank cannot be set aside for fraud or for any other reason, in an action by stockholders against the directors to which the bank has not been made a party. McConnell v. Combination &c. Co. 31 Mont. 563; 79 Pac. 248.

said:[36] "It is contended that the plaintiffs, not having had any knowledge of the want of such authority, are entitled to treat this bill as a bill taken from a partner having a general power of drawing bills, and which might be considered as drawn for partnership purposes, though in fact, it was drawn by one partner in fraud of the others. There is, however, this difference between that case and the present one, that there, there would be no reason for supposing that the bill was not given for partnership purposes; whereas here, the bill was taken by the plaintiffs in payment of a debt, for the discharge of which they knew it was not within the general scope of the authority of the directors of this society to draw bills, for the plaintiffs must have known that the company were constituted under a deed of settlement, to which, being registered pursuant to the statute, the plaintiffs could have had access, and the case which has been referred to by my brother Willes shows that a man must be taken to have knowledge of the contents of a deed of this kind."

§ 229. Notes under corporate seal. Ordinary promissory notes, and other instruments usually made without sealing, are not infrequently issued by corporations under the corporate seal. The seal in such cases is practically without effect. It does not affect the negotiability or validity of the instrument.[37]

Where a note and warrant of attorney are executed in the name and under the seal of a corporation, by its president, the authority to execute it will be presumed.[38]

§ 229a. A note signed by the directors or other officers of a cor-

[36] Balfour v. Ernest, 5 C. B. N. S. 601; 28 L. J. (C. P.) 170, quotation from latter report; and see Hood v. New York &c. R. Co. 22 Conn. 502.

[37] Connecticut Mut. L. Ins. Co. v. Cleveland &c. R. Co. 41 Barb. (N. Y.) 9; Halford v. Cameron's &c. R. Co. 16 Q. B. 442; Aggs v. Nicholson, 1 H. & N. 165; Goodwin v. Robarts, L. R. 10 Ex. 337; General Estates Co. In re L. R. 3 Ch. 758; Landauer v. Sioux City Imp. Co. 10 S. D. 205.

[38] Atwater v. American Exch. Bank, 152 Ill. 605; 38 N. E. 1017; Snyder v. Bailey, 165 Ill. 447; 46 N. E. 452, reversing 61 Ill. App. 472; Anderson Transfer Co. v. Fuller, 174 Ill. 221; 51 N. E. 251; 73 Ill. App. 48; Matson v. Alley, 141 Ill. 284; 31 N. E. 419; Reed v. Fleming, 102 Ill. App. 668.

poration by their individual names, although they describe themselves as such officers, is not the note of the corporation unless it purports to be made on behalf or on account of the company. Even the affixing of the corporate seal to such a note does not make it the note of the corporation, where the parties do not otherwise use terms to exclude their personal liability.[39] But a note signed by individual officers of a corporation, "by and on behalf of the said society," was held to be binding upon the company, and not upon the parties who signed it.[40] And so a note signed by individuals, "for" a corporation named, is binding upon the corporation if the signers had authority to bind it. But where such persons "jointly and severally" promised for a corporation, these words were considered as fixing the undertaking as a personal one.[41]

Where a note signed by the president and secretary of a corporation in their own names is secured by a mortgage on corporation property, reciting an indebtedness of the corporation "secured to be paid by its one promissory note of even date," and reciting a resolution of the directors authorizing the president and secretary to execute the note and mortgage, the note cannot be reformed on foreclosure so as to bind the corporation alone, it appearing that the

[39] Dutton v. Marsh, L. R. 6 Q. B. 361. The note in this case was as follows: "We, the directors of the Isle of Man Slate & Flag Co., limited, do promise to pay J. D. £1,600, with interest at 6 per cent. till paid, for value received." The company's seal was affixed. To similar effect see Daniel v. Glidden, 38 Wash. 556; 80 Pac. 811.

[40] Aggs v. Nicholson, 1 H. & N. 165; Midland Steel Co. v. Citizens' Nat. Bank, 26 Ind. App. 71; 59 N. E. 211. A note signed "T. R. Wagner, Sec'y and Gen'l Manager of the Shelby Lime and Cement Works," was held to bind the company. Wagner v. Brinckerhoff, 123 Ala. 516; 20 So. 117. But the addition of the word "trustees" merely, after the names of the individuals does not bind the corporation. Saint Joseph's &c. Soc. v. St. Hedwig's Church, 3 Penn. (Del.) 229; 50 Atl. 535.

[41] Bradlee v. Boston Glass Manufactory, 16 Pick. (Mass.) 347, cited approvingly by Bramwell, B., in Aggs v. Nicholson, 1 H. & N. 165.

Where the corporation promised in the body of the note and the signature was "A. B., Gen. Supt.," A. B. was held personally liable on the note. Frankland v. Johnson, 147 Ill. 520; 35 N. E. 480. A similar mode of signing has been held to bind the corporation. Second Nat. Bank v. Midland Steel Co. 155 Ind. 581; 58 N. E. 549; 52 L. R. A. 307.

lender relied on the personal security of the officers.[42] But ordinarily it can be shown by parol between the original parties that a note signed by directors was intended by all concerned as a corporation note.[43]

§ 229b. A note containing the words "We jointly and severally promise to pay" "on behalf of the A. B. corporation" and signed by two persons with the official title of directors, creates a personal obligation on the part of the signers. These significant words unmistakably indicate a personal promise on the part of each of the signers of the paper, notwithstanding, in form, they acted for and on behalf of the corporation.[44] So naming the corporation independently of and conjunctively with "we the undersigned" cannot be satisfied without reading out of the paper a promise of the corporation, and also one by those referred to by the quoted words, who sign their own names under the corporate name with the word "per."[45]

Where a note similarly executed omits the words "jointly and severally" from the body of the instrument, it is held to be the obligation of the corporation alone.[46] So the use of the word "we," but

[42] Hackemack v. Wiebrock, 172 Ill. 98; 49 N. E. 984; 71 Ill. App. 170. In Minnesota, where the maker of a promissory note affixes the abbreviation "Pres." to his name, he is prima facie liable on the note, and can only escape personal liability by showing that the payee understood it to be a corporation note, that the making of the note was not ultra vires, and that the corporation authorized its execution. Brunswick-Balke &c. Co. v. Boutell, 45 Minn. 21; 47 N. W. 261.

Where nothing appears in the body of a note to indicate the maker and the note is signed by a corporate name under which appears the name of an officer of the company, with his corporate official title affixed thereto, in such case the note is taken conclusively to be that of the corporation. Reeve v. First Nat. Bank, 54 N. J. L. 208; 23 Atl. 853; 16 L. R. A. 143; 33 Am. St. 675.

[43] McGarry v. Tanner & Bakes Co. 21 Utah, 16; 59 Pac. 93.

[44] Healy v. Story, 3 Exch. 3. But see Holt v. Sweetzer, 23 Ind. App. 237; 55 N. E. 254.

[45] Nunnemacher v. Poss, 116 Wis. 444; 92 N. W. 375.

[46] Simpson v. Garland, 76 Me. 203; Jefts v. York, 4 Cush. (Mass.) 371; Jones v. Clark, 42 Cal. 180; Pearse v. Welborn, 42 Ind. 331; Lindus v. Melrose, 3 Hurl. & N. 177; Williams v. Harris, 198 Ill. 501; 64 N. E. 988, reversing 98 Ill. App. 27.

not conjunctively with some other person or persons, does not place a personal liability upon those signing on behalf of the corporation.[47] Directors indorsing a corporation note as such have been allowed to show against a holder with notice that they did not intend to become personally liable as indorsers.[48]

II. *Unsecured Bonds of Corporations.*

§ 230. At common law a private corporation has the power to issue bonds not secured by mortgage, for any purpose for which it may lawfully contract a debt. No special legislative authority is needed unless some restriction is imposed by the company's charter, or by general enactment. "A bond is merely an obligation under seal. A corporation having the capacity to sue and be sued, the right to make contracts under which it may incur debts, and the right to make and use a common seal, a contract under seal is not only within the scope of its powers, but was originally the usual and peculiarly appropriate form of corporate agreement."[49] Restrictions upon the issuing of bonds have been imposed in some states, and where this is the case they can be issued only in the mode and for the purposes authorized. Bonds issued in disregard of such statutes are void.[50] They may be repudiated, not only by the

[47] Draper v. Massachusetts &c. Co. 5 Allen (Mass.), 338; Miller v. Roach, 150 Mass. 140; 22 N. E. 634; 6 L. R. A. 71; Gleason v. Sanitary &c. Co. 93 Me. 544; 45 Atl. 835; 74 Am. St. 370; Farmers' &c. Bank v. Colby, 64 Cal. 352; 28 Pac. 118; Fond du Lac v. Otto, 113 Wis. 39; 88 N. E. 917; 90 Am. St. 830.

[48] Kline v. Bank of Trescott, 50 Kan. 91; 31 Pac. 688; 18 L. R. A. 533; 84 Am. St. 107. See Taylor v. Reger, 18 Ind. App. 466; 48 N. E. 262; 63 Am. St. 352, where signers failed to show they did not become personally bound.

[49] Commonwealth v. Smith, 10 Allen (Mass.), 448, per Hoar, J., 87 Am. Dec. 672.

[50] Commonwealth v. Smith, 10 Allen (Mass.), 448, per Hoar, J., 87 Am. Dec. 672. Under the rule that the powers of corporations are such and such only as the statutes confer, Thomas v. Railroad Co. 101 U. S. 71, it was held that the Philadelphia &c. R. Co. had not the right by their charter to issue deferred income bonds, being irredeemable bonds with certain rights similar to those of a stockholder. McCalmont v. Philadelphia &c. R. Co. 14 Phila. (Pa.) 479; 38 Leg. Int. 168.

corporation itself, but by a subsequent mortgagee whose mortgage is not made expressly subject to them.

A railroad company unless restrained by statute has power to contract debts, and the power to acknowledge its indebtedness by making bonds under its seal.[51] This is a very different question from that which relates to the power of such corporation to mortgage its property without legislative authority.

§ 231. **A corporation having the power to borrow money for a specific purpose** has the right to issue any instrument in acknowledgment of the debt which the parties may consider convenient. It may issue bonds for such debt without the aid of any statute in terms conferring the power to issue bonds.[52] Such corporation has the same power as an individual to issue any kind of instrument acknowledging its indebtedness and promising payment. The bonds of a corporation having the power to borrow, but not the power to grant a mortgage to secure the loan, are valid, although the mortgage is void. In such case, when it is sought to enforce the bonds, the power to issue them is all the court has to do with, and the company is liable upon them without regard to the mortgage.[53]

A statute authorizing a railroad company to borrow money from time to time for maintaining and working the railroad, and to pledge the lands, tolls, and revenues, and to make bonds or debentures for securing the payment of the sums borrowed, does not restrict a company to the use of bonds or debentures rather than other evidences of debt.[54]

§ 232. **A statutory bond or debenture holder in England** occupies a position quite different from that of a mortgagee; while the latter has a lien upon the tolls and traffic receipts of the undertaking, and may have a receiver of them appointed for the purpose

[51] Craven v. Atlantic &c. R. Co. 77 N. C. 289.

[52] Miller v. N. Y. & Erie R. Co. 18 How. Pr. (N. Y.) 374; 8 Abb. Pr. (N. Y.) 431; Dana v. Bank of United States, 5 W. & S. (Pa.) 223; Kelly v. Alabama &c. R. Co. 58 Ala. 489.

[53] Philadelphia &c. R. Co. v. Lewis, 33 Pa. St. 33.

[54] Commercial Bank v. Great Western R. Co. 3 Moore P. C. C. (N. S.) 295.

of paying his claim, the former has no such lien or right to have a receiver appointed.[55] A judgment creditor might, prior to the Railway Companies Act of 1867, as against such bondholder, levy his execution upon the personal or real property of the company.[56] Although such creditor had recovered his judgment upon a debenture, if his execution was paid before any of the other bondholders intervened, he might keep what he had received. He might bring a suit in behalf of himself and all other bondholders, but was not bound so to do. The non-priority clauses of the statute were regarded as applying between executions and not as between bonds.[57]

An English company owning land in Italy issued bonds or debentures binding their "estate, property, and effects," and it was claimed that they constituted a charge upon the land, and that the debenture holders could restrain a sale of it under a subsequent mortgage; but the Master of the Rolls held them to be merely bonds, and that they created no mortgage or lien; that even if they had been mortgages they could not be preferred to subsequent mortgages which had been perfected by registry according to the law of Italy, although the mortgagees had notice, according to the English law, of the prior charge; and further, that the Italian court was the proper forum to exercise jurisdiction in the matter.[58]

§ 233. Prohibition against issuing notes for circulation as money. Bonds of a canal or railroad company issued in the course of its legitimate business do not fall within a statutory prohibition against issuing notes for a circulating medium in the similarity of a bank note, the intention of the statute being to prohibit the exercise of banking privileges.[59] It was urged that inasmuch as the legislature had conferred upon the canal company power to borrow money on mortgage to enable it to complete its work, this authority covered the whole scope of power possessed by the company, and it could not issue bonds without such mortgage; and it was insisted that

[55] Imperial Mercantile &c. Ass. v. Newry &c. R. Co. 2 Ir. Eq. 524; Preston v. Great Yarmouth, L. R. 7 Ch. 655.

[56] Bowen v. Brecon R. Co. L. R. 3 Eq. 541, 548; Russell v. East Anglian Ry. Co. 3 Mac. & G. 104, 151.

[57] Imperial Mercantile &c. Ass. v. Newry &c. R. Co. 2 Ir. Eq. 524.

[58] Norton v. Florence Land &c. Co. 26 Week. R. 123.

[59] McMasters v. Reed, 1 Grant. (Pa.), 36; Hubbard v. New York &c. R. Co. 36 Barb. (N. Y.) 286.

the parties executing such bonds made themselves personally liable. But it was held that the company had of necessity the right to enter into such obligations in carrying out the purposes of the corporation, and that the obligations were binding upon it.[60]

An insurance and loan company which was forbidden "to issue for circulation as money any of its own promissory notes in the nature of bank notes or certificates of deposit payable to bearer," having issued certain certificates of deposit payable to order, it was found as a fact that they were not intended for circulation as money. After an indorsement in blank by the payee, they in effect became payable to bearer; and it was admitted in point of law that they were fully negotiable; but it was decided that the issue of these instruments was not illegal, and that therefore the company was liable upon them.[61]

§ 234. **The issuing of income bonds,** for the payment of the interest of which the income of a railroad company is specifically pledged, does not debar the company of the legal right to execute a mortgage of its road and property to secure the payment of other bonds. The pledge of the income is binding upon the company, but is no incumbrance upon the property itself, which, under a subsequent mortgage, may be taken out of the possession of the company and applied to the payment of the mortgage debt.[62]

A railroad company having made a first and second mortgage of its property issued certain income bonds, wherein it was recited, that "for the punctual payment of the interest and principal of said obligations, and of others of like tenor, issued or to be issued, in preference to the payment of dividends on the capital stock of said company, the income arising from the road and its appurtenances is hereby specifically pledged;" subsequently the company executed a mortgage of its whole line, and was about to issue bonds under it, when the holders of certain of the income bonds filed a bill to restrain the sale of the mortgage bonds. It was contended in their behalf that the company could not, without a violation of their own

[60] McMasters v. Reed, 1 Grant (Pa.) 36.

[61] Mumford v. American Life Ins. &c. Co. 4 N. Y. 463.

[62] Perkins v. Deptford Pier Co. 13 Sim. 277, 281.

obligations, tantamount to fraud, attempt to impair the unrecorded lien on their property by placing on record a mortgage designed to secure third mortgage bonds to be paid in order after the first and second mortgage bonds; and therefore that the company ought to be restrained from issuing the third mortgage bonds, which, in the hands of *bona fide* purchasers without notice of the unrecorded lien of the income bonds, would be preferred. It was held, however, that fraud could not be imputed to the company in consequence of the issuing of the third mortgage bonds, and that it was not in any way precluded from executing such subsequent obligations. The terms of the income bonds were declared to be specific, and the holders confined to the preference therein set forth.[63]

[63] Garrett v. May, 19 Md. 177

CHAPTER VIII.

INTEREST AND INTEREST COUPONS.

I. The contract to pay interest, §§ 235–237.
II. Negotiability of coupons, §§ 238–245.
III. Order of payment of coupons, §§ 246–255.
IV. Interest on overdue coupons and bonds, §§ 256–260.
V. Suits upon coupons, §§ 261–267.

I. *The Contract to pay Interest.*

§ 235. The terms in which coupons are expressed are very different. Usually they are in the form of express promises to pay the interest due at fixed times to the bearer at a place designated.[1] In such case the instrument is a complete contract in itself, and may, when consistent with the terms of the bond, be declared on as such without reference to the bond. But sometimes a coupon is merely a memorandum of the interest due, and of the time and place of payment, without any express promise of payment.[2] In such case the coupon is not a complete instrument in itself, and can be declared on only in connection with the bond. Again, a coupon may be in the form of a draft for the interest in favor of bearer.[3] In such case, however, the coupon is not strictly a bill of exchange. It is not intended for acceptance. It is usually drawn against funds deposited to meet it, and is therefore more like a check. If such

[1] As in Thomson v. Lee County, 3 Wall. (U. S.) 327.

[2] As in Woods v. Lawrence County, 1 Black (U. S.), 386.

[3] Sheboygan County v. Parker, 3 Wall. (U. S.) 93; Arents v. Commonwealth, 18 Gratt. (Va.) 750, 774.

a coupon be construed as a mere token or ticket or warrant, indicating the time when and the place where the interest is due, it will satisfy the terms in which it is expressed, and be consistent with the bond and the purpose for which the coupon was devised.[4]

Whatever be the form of the coupon, its purpose is substantially the same, which is to afford to the holder evidence of his right to demand the interest according to the provisions of the bond, and a convenient mode of collecting it; and to afford to the maker of the bond a convenient voucher of the payment of the interest.

The contract for the payment of the interest is generally fully defined by the bonds, while the coupon for the interest often expresses the contract very imperfectly. When such is the case, the instruments necessarily being construed together, the bond determines what the contract is. A coupon, also, which in terms differs from the contract contained in the bond, must, by construction, be made consistent with that contract; and in this connection the purpose for which the coupon is given is to be considered.

The cutting of the coupon from the bond does not change the contract as determined by the bond and mortgage.[5] Then, inasmuch as the bond necessarily refers to the mortgage securing it, the provisions of the mortgage with reference to the terms and conditions of payment necessarily affect the character of the coupon, determining, for instance, its negotiability.[6]

Coupons are often signed by a printed *fac-simile* of the autograph of the maker, or of the officer empowered to execute the bonds; and this constitutes a legal signature, though not expressly authorized by statute.[7]

Coupons attached to a bond are a part of it, and are affected by its infirmities as well as endowed with its strength, and their character is not changed by detaching them from the bond without the consent of the purchaser thereof.[8]

[4] Arents v. Commonwealth, 18 Gratt. (Va.) 750, 774.

[5] McClelland v. Norfolk &c. R. Co. 110 N. Y. 469; 18 N. E. 237; 1 L. R. A. 299n; 6 Am. St. 397.

[6] McClelland v. Norfolk So. R. Co. 110 N. Y. 469; 18 N. E. 237; 1 L. R. A. 299n; 6 Am. St. 397.

[7] Pennington v. Baehr, 48 Cal. 565; McKee v. Vernon County, 3 Dill. (U. S.) 210; Lynde v. County, 16 Wall. (U. S.) 6.

[8] Hudson Valley R. Co. v. O'Connor, 95 App. Div. (N. Y.) 6; 88 N. Y. S. 742.

§ 236. Usury laws do not generally apply to bonds issued by corporations. They are expressly excepted from the operation of the statutes in several states.[9] In England debentures may be issued at a discount, and the holders will be allowed to prove for the full nominal amount in proceedings for winding up.[10]

The usury laws apply to corporations, in the absence of special legislation, to the same extent as to natural persons, and corporations cannot, any more than individuals, legally sell their bonds, bearing the highest rate of interest, at a discount, for the purpose of borrowing money.[11]

A statute authorizing corporations to sell their bonds at a discount may have no application to foreign corporations, so that the same provisions as to interest and usury apply to them that apply to private individuals.[12]

A special clause in a charter, authorizing a company to borrow money on such terms as may be agreed upon by the parties, overrides an existing general law upon the subject, and enables it to borrow at any rate of interest.[13]

[9] Dakota: R. Civil Code 1883, § 434.

Iowa: 1 R. Code 1880, § 1283.

Maine: R. S. 1883, ch. 51, § 56.

Minnesota: Stats. 1878, p. 382, § 71.

Nebraska: Comp. Stats. 1885, ch. 16, § 117.

New Jersey: 2 R. S. 1877, p. 931, § 108.

New York: R. S. 1889, p. 1732, § 1.

Ohio; for case construing local statute to have this effect see Metropolitan Trust Co. v. Railroad Equip. Co. 108 Fed. 913.

Wisconsin: R. S. 1878, § 1690.

In several other states and territories there are no usury laws. See Jones Mortgages, § 633.

[10] Anglo-Danubian Steam Nav. Co. In re, L. R. 20 Eq. 339; Foss v. Harbottle, 2 Hare, 461; Regent's Canal Iron Works Co. In re, 24 W. R. 687; Planters' Warehouse Co. v. Johnson, 62 Ga. 308; In Blakely Ordnance Co. In re, L. R. 8 Eq. 244, the master of the Rolls, Romilly, allowed proof for only the sum actually advanced.

[11] Craven v. Atlantic &c. R. Co. 77 N. C. 289.

An issue of 6 per cent. bonds by a corporation to be sold at 75 cents on the dollar is usurious; but such an issue of bonds is not ultra vires in the ordinary sense of the term. Fletcher v. Alpena Circuit Judge, 136 Mich. 571; 99 N. W. 748.

[12] McGregor v. Covington &c. R. Co. 1 Dis. (Ohio) 509.

[13] Morrison v. Eaton &c. R. Co. 14 Ind. 110; Traders' Nat. Bank v. Manufacturing Co. 96 N. C. 298; 3 S. E. 363. A similar provision in

Under a statute authorizing the sale of corporate bonds at less than par value, there can be no ground of objection to an exchange of the bonds for iron rails. It could make no difference whether the bonds were sold at a reduced rate and the iron rails bought for cash, or the bonds exchanged directly for the iron rails; the transaction might easily be made to assume either form.[14]

When a statute limits the rate of interest a corporation may pay for loans, but does not provide for the times of payment, it is a proper exercise of the power to make the interest payable semi-annually. So long as the specified rate be not exceeded, the payment of the interest may be regulated according to the usual course of dealing in borrowing money.[15]

§ 237. The law of the place where a bond is made payable, as a general rule, determines whether it is usurious or not. If it be not usurious by that law, a plea of usury cannot be sustained, unless it alleges that the place of payment was inserted as a shift to evade the law of the place where the bond was made.[16] A usurious mortgage, securing an issue of bonds, was executed in New York by a New Jersey corporation covering real estate in New Jersey, and it was held by a New Jersey court that the local law against usury could not be set up. It being a New York contract, its validity must be determined by the law of that state.[17]

When the rate of interest at the place where the bonds are made

a bank charter was held to confer a power to be exercised under the restraints of the general law, and not independently of them; for it was not supposed that it was the intention, in granting the charter, to relieve the bank from the restraints imposed upon all other banking institutions, to the oppression of borrowers from such bank. In the cases referred to in the text, the enabling clause is for the benefit of the borrower. A distinction is to be observed between a provision allowing corporations to lend money at a usurious rate of interest, and a provision allowing a corporation to borrow money at such rate. Simonton v. Lanier, 71 N. C. 498.

[14] Coe v. Columbus &c. R. Co. 10 Ohio St. 372; 75 Am. Dec. 518n.

[15] Coe v. Columbus &c. R. Co. 10 Ohio St. 372; 75 Am. Dec. 518n.

[16] Junction R. Co. v. Bank of Ashland, 12 Wall. (U. S.) 226; Butler v. Myer, 17 Ind. 77; Butler v. Edgerton, 15 Ind. 15.

[17] Franklin Trust Co. v. Rutherford Elec. Co. 57 N. J. Eq. 42; 41 Atl. 488.

differs from that at the place where they are made payable, the parties may stipulate for either rate, and their contract will govern.[18]

The laws of the state where the corporation was organized and issued its bonds determine the question of usury as to such bonds, in a suit in the same state to enforce them, although they are made payable in another state, whose laws are different.[19] The statute of such other state where the bonds are made payable might control in an action upon the bonds in that state.

II. *Negotiability of Coupons.*

§ 238. Coupons which promise payment to bearer are in legal effect promissory notes by the law merchant, and possess all the attributes of negotiable paper.[20] The purchaser of such coupons is not an assignee of the causes of action, but he acquires title by delivery, and the promise to bearer is a promise to himself directly.[21]

[18] 1 Jones Mortgages, §§ 656–663; Cromwell v. County of Sac, 96 U. S. 51, 62; Miller v. Tiffany, 1 Wall. (U. S.) 298.

[19] Craven v. Atlantic &c. R. Co. 77 N. C. 289.

[20] Mercer County v. Hacket, 1 Wall. (U. S.) 83; Thomson v. Lee County, 3 Wall. (U. S.) 327; Aurora City v. West, 7 Wall. (U. S.) 82, 105; Clark v. Iowa City, 20 Wall. (U. S.) 583; Kennard v. Cass County, 3 Dill. (U. S.) 147; Chesapeake &c. Co. v. Blair, 45 Md. 102, 110; Cicero v. Clifford, 53 Ind. 191; Gilbough v. Norfolk &c. R. Co. 1 Hughes (U. S.) 410; Arents v. Commonwealth, 18 Gratt. (Va.) 750; Miller v. Berlin, 13 Blatchf. (U. S.) 245; Cooper v. Thompson, 13 Blatchf. (U. S.) 434; Haven v. Grand Junction R. &c. Co. 109 Mass. 88; Spooner v. Holmes, 102 Mass. 503; 3 Am. R. 491; First Nat. Bank v. Mount Tabor, 52 Vt. 87; 36 Am. R. 734; Bailey v. County of Buchanan, 22 J. & S. (N. Y.) 237; Kansas City M. &c. R. Co. v. Cobb, 100 Ala. 228; 13 So. 938; Trustees of Int. Imp. Fund v. Lewis, 34 Fla. 424; 16 So. 325; 26 L. R. A. 743; 43 Am. St. 209.

Contra, but not authorities, Clarke v. Janesville, 1 Biss. (U. S.) 98; Myers v. York &c. R. Co. 43 Me. 232.

[21] Cooper v. Thompson, 13 Blatchf. (U. S.) 434, 437; Lexington v. Butler, 14 Wall. (U. S.) 282, 283. Each matured coupon is a separable promise, and gives rise to a separate cause of action. It may be detached from the bond and sold by itself. While the promises of the bond and of the coupon in the first instance are upon the same paper, and the coupons are for interest due on the bonds, yet the

Even when the coupons themselves do not purport to be negotiable, if the bonds to which they belong are negotiable, the coupons are negotiable also, so long as they are not detached from the bonds. The title to negotiable interest coupons passes from hand to hand by mere delivery, and a transfer of possession is presumably a transfer of title, but does not import a guaranty of payment.[22]

§ 239. Coupons are not rendered non-negotiable by the fact that they are not made payable to bearer.[23] Such coupons are to be taken in connection with the bonds to which they are annexed, and though not themselves negotiable instruments by the law merchant, they follow the instrument to which they are attached, and when that is negotiable the coupons are negotiable.[24] The obligation to pay the interest is to be found in the bond, not in the coupons. These are intended by the parties to be evidence of debt in the hands of the holder, and proof of payment when in possession of the debtor. By the contract of the parties and the usage of the country, they are sufficient evidence of a debt to the holder as against the obligors of the bonds. The possession of them is *prima facie* evidence that the holder is the holder of the bond, or was so when they were cut off, and as such entitled to receive the interest.

§ 240. On the other hand, though the coupons are payable to bearer, they may be rendered non-negotiable by the terms of the

promise to pay the coupon is as distinct from that to pay the bond as though the two promises were placed in different instruments, upon different paper. Nesbit v. Independent Dist. 144 U. S. 610; 12 Sup. Ct. 746; Rice v. Shealey, 71 S. Car. 161; 50 S. E. 868. Detached coupons are not subject to the conditions of the bond and mortgage. Haskins v. Albany &c. R. Co. 74 App. Div. (N. Y.) 31; 76 N. Y. S. 667.

[22] Ketchum v. Duncan, 96 U. S. 659; Fox v. Hartford &c. R. Co. 70 Conn. 1; 38 Atl. 871.

[23] Smith v. Clark, 54 Mo. 58. The coupons in this case were in the following form: State of Missouri. Bond No. 51. $35. The county of Clark will pay thirty-five dollars on this coupon on the first day of January, 1867, at the treasury of said county."

[24] McCoy v. Washington Co. 3 Wall. (U. S.) Jr. 381. The coupons were as follows: "Washington County Bonds. Warrants for thirty dollars interest on bond No. 108, payable in the city of New York on the 15th of May, 1857." See § 242.

bond and mortgage, through a reference contained in the coupons to the bond upon which they represent the interest payable. It is essential to the negotiability of an instrument that it should be payable unconditionally. When, therefore, the mortgage invests a majority of the bondholders with the power, at their option, to waive defaults in the payment of the moneys secured by the mortgage, the negotiable character of the bonds is destroyed; and if the coupons, though payable to bearer and detached from the bonds, refer to the bonds and purport to be for the payment of the semi-annual interest accruing thereon, a purchaser is put upon inquiry, and is chargeable with notice of all the bonds contain, or that the mortgage securing the bonds contains, and the coupons partake of the non-negotiable character of the bonds. After the majority of the bondholders have exercised this power of waiver in accordance with the terms of the mortgage, and further in accordance therewith have postponed the payment of interest thereunder for a definite period, an action at law cannot be maintained upon the coupons until the period of extension has expired, though the plaintiff, as holder of such coupons, has not assented to the postponement.[25] But every coupon holder would have the right to insist that the conditions of the exercise of the power of waiver should be exactly complied with; and therefore, where the mortgage provided that no action of the trustees or of the bondholders should have any effect on any subsequent default, there could be no effectual waiver of a default in anticipation of it, and therefore a waiver of such future defaults would be no defence to an action upon coupons subsequently falling due.[26]

§ 241. **Interest coupons, detached from bonds,** payable to bearer at a specified time and place, are negotiable promises for the payment of money, and therefore subject to the same rules as bank bills or other negotiable instruments.[27] Such coupons, having been

[25] McClelland v. Norfolk &c. R. Co. 110 N. Y. 469; 18 N. E. 237; 6 Am. St. 397; 4 Railw. & Corp. L. J. 545.

[26] McClelland v. Norfolk So. R. Co. 110 N. Y. 469; 18 N. E. 237; 6 Am. St. 397.

[27] Clark v. Iowa City, 20 Wall. (U. S.) 583; Aurora City v. West, 7 Wall. (U. S.) 82; Walnut v. Wade, 103 U. S. 683; Hinckley v. Union Pac. R. Co. 129 Mass. 52; 37 Am. R. 297; First Nat. Bank v. Mount Tabor, 52 Vt. 87; 36 Am. R.

detached and sent to New York by express, on March 31, 1871, for presentation and payment, were on that day stolen from the express office, and on the third day of April following were purchased by the plaintiff in good faith at Albany. He was held to have acquired a valid title to them as against the true owner. The fact that the coupons are declared to be for interest upon bonds specified by their numbers does not destroy their negotiability when separated from the bond, or impair the title of one purchasing from another without production of the bond.[28] Though overdue, such coupons are still negotiable instruments, and one who has taken them before may after maturity give a good title to another.[29]

A coupon for accrued interest, payable to bearer, is just as much a lien under the mortgage given to secure the bond as the bond itself; and it is just as much a lien after it is detached from the bond as before, and when held by another person as when held by the bondholder. The fact that the coupon is made payable to bearer shows that a severance from the bond was contemplated. It is part of the mortgage debt, and being made capable of separate transfer, an assignment of it carries a corresponding interest in the mortgage security. Upon a foreclosure of the mortgage, the holder of a detached coupon is entitled to a pro rata distribution with the holders of the residue of the mortgage debt.[30]

Where no bonds or obligations are secured except those that are certified by the trustee, coupons that are detached before the bonds are certified, sold, or delivered, and before they have any inception as secured obligations, do not come within the protection of the mortgage lien. They do not represent accrued interest within the mean-

737; De Graaf v. Wyckoff, 13 Daly (N. Y.), 366.

[28] Evertson v. National Bank of Newport, 66 N. Y. 14; 23 Am. R. 9. The form of the coupons was as follows: "$35. The Indianapolis &c. R. Company will pay the bearer, at its agency in the city of New York, thirty-five dollars, in gold coin, on the 1st day of April, 1871, for semi-annual interest on bond No. . . . .

A. P. Lewis, Secretary."

[29] Grand Rapids &c. R. Co. v. Sanders, 54 How. Pr. (N. Y.) 214; Arents v. Commonwealth, 18 Gratt. (Va.) 750.

[30] Miller v. Rutland &c. R. Co. 40 Vt. 399; 94 Am. Dec. 413; Sewall v. Brainerd, 38 Vt. 364; Long Island &c. Co. v. Long Island &c. R. Co. 85 App. Div. (N. Y.) 36; 82 N. Y. S. 644.

ing of the mortgage. The amount secured by the mortgage includes only the principal of the bonds and such coupons as remained attached when the bonds are certified and delivered to the parties who purchase them, the security of the mortgage inuring only to the bondholders, as such. This rule was declared in a case where the person holding the coupons was not a *bona fide* purchaser.[31]

§ 242. But coupons not payable to bearer or order are not negotiable when separated from the bonds.[32] It is doubted whether the parties to an instrument can give it a negotiable character, with all the incidents pertaining to negotiable papers, when it is not in terms within the class of instruments known to the law as negotiable.[33] It is not essential that an interest warrant should be negotiable for the purpose of its serving as authority from the railroad company to its financial agent to pay the amount named in it upon presentation, although detached from the bonds.[34] Therefore, one

[31] Holland Trust Co. v. Thomson-Houston Elec. Co. 170 N. Y. 68; 62 N. E. 1090.

[32] Evertson v. National Bank of Newport, 66 N. Y. 14, 20; 23 Am. R. 9. The form of the warrant was as follows: "$35. Interest warrant for thirty-five dollars ($35), upon bond No. of the Danville, Urbana, Bloomington & Pekin Railroad Company. Payable in gold coin at the office of the Farmers' Loan & Trust Company in the city of New York, April 1, 1871.

"W. J. Ermentrout, Secretary."

See, also, Myers v. York &c. R. Co. 43 Me. 232; Jackson v. York &c. R. Co. 48 Me. 147; Crosby v. New London &c. R. Co. 26 Conn. 121.

[33] Crouch v. Credit Foncier, L. R. 8 Q. B. 374.

[34] In Evertson v. National Bank of Newport, 66 N. Y. 14, 20; 23 Am. R. 9, Mr. Justice Allen said: "It is possible that, as between such agent and the debtor corporation, the possession and presentment of the interest warrants at maturity would be evidence of an authority to receive the money by the person presenting it, even as against the true owner. But if this be conceded, it does not make them negotiable as between third persons. In this contract, as in others, its negotiability depends upon its terms; and the rule is, with certain exceptions not applicable to this case, that in instruments for the payment of money, if no one be designated as payee, either by name or as bearer, the instrument is not a promissory note. If these warrants are not promissory notes, they are not negotiable; they are neither checks nor bills of exchange. . . . . The contract embodied in these interest warrants, so far as any contract can be implied, cannot, up-

who in good faith purchased such warrants after they had been stolen from the rightful owner acquired no better title to them than his vendor had and could convey, and the transaction was the same in legal effect as the purchase of any article of merchandise from one having no title or authority to sell.

Dividend warrants of the Bank of England payable to a particular person, without words making them transferable, were held not negotiable, although by custom they had been so treated for sixty years.[35]

§ 243. Overdue coupons, like other overdue negotiable instruments, though in the hands of a *bona fide* purchaser for value, are subject to all the defences and equities that attach to ordinary choses in action; the purchaser takes no better title than the party from whom he received them had.[36]

A purchaser of overdue coupons takes only the title of the vendor, and therefore acquires no title at all to such coupons when they have been obtained by fraud or theft.[37]

If the corporation pays overdue coupons to the person presenting them after notice that they have been stolen, the corporation is liable as promisor to the true owner; and it is not necessary that such notice should contain an offer of a bond of indemnity.[38]

The fact that past due coupons are attached to a bond at the time of its purchase does not invalidate the purchaser's title as a *bona fide* purchaser of the coupons thereafter to become due, and of the bond itself.[39] The burden of proof is upon the defendant to

on principle or within any well-considered authority, be made an exception to the general rules by which the negotiability of promises for the payment of money is determined. There is no usage or custom proved that would give these warrants a negotiable character, even if custom and usage so recent as one applicable to these instruments would be could change their legal effect."

[35] Partridge v. Bank of England, 9 Q. B. 396.

[36] Arents v. Commonwealth, 18 Gratt. (Va.) 750; Martin v. Bank, 94 Tenn. 176; 28 S. W. 1097.

[37] Gilbough v. Norfolk &c. R. Co. 1 Hughes (U. S.), 410.

[38] Hinckley v. Union Pac. R. Co. 129 Mass. 52; 37 Am. R. 297.

[39] Miller v. Berlin, 13 Blatchf. (U. S.) 245, 250; Child v. New York &c. R. Co. 129 Mass. 170. See Farmers' &c. Co. v. Oregon &c. R. Co. 58 Fed. 639, as to bona fide holder of coupons.

show the existence of any other facts which, in connection with the overdue coupons, might deprive the purchaser of the character of a *bona fide* holder.

Certificates issued for overdue interest do not constitute a novation of the debt, unless a novation be shown to have been intended. Such interest is still a lien if the debt was originally a lien.[40]

§ 244. **A coupon is ordinarily considered due** and payable, aside from the question of days of grace, on the day when the interest it represents is by the terms of the bond made payable.[41] It is not the less payable at such times because the bond provides that the interest shall be paid on presenting or surrendering the proper coupon. This evidence of title must be produced before the money it calls for can be demanded, and it must be surrendered when the money is paid. But this is just what the law requires of every holder of a negotiable security, and no more. Such a coupon, as to the time of its maturity, is different from a note payable on demand. It becomes due without any demand or presentation.[42]

§ 245. **Negotiable interest coupons are entitled to days of grace,** like other negotiable instruments payable at a given day or on time; and therefore one purchasing them after the expiration of the time of payment specified, but before the expiration of the days of grace, is a purchaser before maturity.[43] Such coupons having every other

[40] Atlantic &c. R. Co. In re, 3 Hughes (U. S.), 320.

[41] Arents v. Commonwealth, 18 Gratt. (Va.) 750, 776. The coupon in this case was as follows: "Coupon, city of Wheeling, guaranteed by the State of Virginia. Duncan, Sherman & Co., of New York, will pay the bearer thirty dollars, the half-yearly interest on the Wheeling bond 269, due 1st January, 1867. M. Nelson, Mayor."

[42] Walnut v. Wade, 103 U. S. 683.

[43] Evertson v. National Bank of Newport, 66 N. Y. 14, 22; 23 Am. R. 9n. See Cooper v. Thompson, 13 Blatchf. (U. S.) 434, 438, where above case is cited. In Evertson v. National Bank of Newport, 66 N. Y. 14, 22; 23 Am. R. 9n, Allen, J., said: "It is probably true that they are regarded and treated, as well by promisor as promisee, as payable at the day, and payable as if, in terms, payable without grace; but this cannot destroy the character or change the legal effect of the instruments, the interpretation of which is for the courts. It is only as negotiable commercial paper that the plaintiff, as a bona fide purchaser, could acquire a good

characteristic of promissory notes, they cannot be excepted from the general rule which by commercial usage, sanctioned by law, is applied to every instrument, negotiable in its character, coming within the ordinary definition of bills of exchange or promissory notes. If they were payable at a fixed day without grace, a purchaser after that day would take them as overdue paper, and would gain no better title than the vendor had. It is not doubted that a negotiable bond, payable at a given day or on time, is entitled to days of grace; and there can also be no doubt that negotiable coupons are entitled to the same privilege.

§ 246. **Money bonds and interest coupons are not entitled to grace in Massachusetts,** where, by virtue of a statute, grace is allowed, in like manner as on foreign bills of exchange, on all bills of exchange payable at sight, or at a future day certain, and on all promissory negotiable notes, orders, and drafts payable at a future day certain.[44]

III. *Order of Payment of Coupons.*

§ 247. **Payment of coupons should be made in the order in which they fall due;** and it is doubtless true that the holder may in equity claim payment in this order; and it has sometimes been

title to the coupons from one having no title thereto; and he can only acquire such title by a purchase under the same circumstances that would give him a title to other commercial paper; and if there were no days of grace for the payment of these coupons, they could not be transferred so as to give a good title."

[44] Chaffee v. Middlesex R. 146 Mass. 224, 235; 16 N. E. 34. The court express dissatisfaction with the decision in Evertson v. National Bank of Newport. "The reasons," says Field, J., "why days of grace were originally allowed on foreign bills of exchange payable at sight, or at a future day certain, have little application to bonds with coupons issued by a corporation to obtain money, which usually have a long time to run, and are commonly bought and held as an investment. Such bonds and coupons do not serve the purposes of commercial paper."

Under the Negotiable Instruments Act, ch. 73, R. L. 1902, grace is allowed only on foreign bills of exchange.

claimed that a holder of coupons separated from the bonds ought to be paid before the bondholder, because that would be the order of payment if the bonds and coupons were held by the same party.[45] As between debtor and creditor the law, it is true, applies payment first to extinguish the interest;[46] but where a part of the mortgage debt has been assigned, and the mortgage security is about to be appropriated to pay the debt, and is insufficient to pay the whole, mere priority of maturity does not give any right to priority of satisfaction.[47] Neither is the coupon holder entitled to priority over the holder of the bond from which it was detached in a final distribution of the proceeds of the whole mortgaged property. The bond and the coupon are entitled to a pro rata distribution.[48]

Thus, where it appeared that the promoter of a corporation had become indebted to material-men for the construction of its works, and that in payment therefor he turned over to these creditors bonds of the company from which he had detached overdue coupons, it was held that it would be inequitable to permit the promoter to use these coupons as a basis of a preference over purchasers of the bonds from which they had been cut, and purchasers of such coupons after maturity would have no greater rights.[49]

The appointment of a receiver is for the protection of all parties interested in the mortgaged property. When, therefore, a subsequent mortgagee has obtained the appointment, he is not entitled to have the interest coming due on his mortgage paid out of the receipts of the road, to the exclusion of a prior mortgagee, upon the ground that the bonds secured by such subsequent mortgage are so drawn that the principal debt becomes due and payable if the interest be not paid.[50]

Bonds issued in exchange for coupons and secured by a second mortgage are not entitled to preference, in the application of the proceeds of a foreclosure sale over first mortgage bonds from which the coupons were taken.[51]

[45] See § 647.

[46] 1 Jones Mortgages, § 911.

[47] Sewall v. Brainerd, 38 Vt. 364.

[48] Sewall v. Brainerd, 38 Vt. 364; Miller v. Rutland &c. R. Co. 40 Vt. 399.

[49] Wood v. Guarantee Trust &c. Co. 128 U. S. 416; 9 Sup. Ct. 131.

[50] Brown v. New York &c. R. Co. 22 How. Pr. (N. Y.) 451.

[51] Farmers' &c. Co. v. Green Bay &c. R. Co. 6 Fed. 100. See § 647.

§ 248. Coupons severed from negotiable bonds are not entitled to priority of payment over the principal of the bonds or coupons subsequently maturing, unless the mortgage expressly provides for such priority.[52]

A railway mortgage contained the following clause: "In case of default in the payment of interest or principal of any bonds, and a sale or other proceeding to coerce the same, all bonds which shall then be a lien in common therewith, and the interest accrued thereon, shall be considered, and shall in fact be, equally due and payable, and entitled to a pro rata dividend of the proceeds of said sale or other proceedings; but in no case shall the principal of any bond be considered due until twenty years from the date thereof." Upon a sale under the mortgage within the twenty years, it was held that the overdue interest warrants were entitled to no preference; and it was declared that the provision, that no bond should be considered due until twenty years after its date, was inserted merely to exclude any possible inference that a bondholder under any circumstance might bring an action for the principal before it became due by its terms.[53]

A provision that coupons shall be paid first out of the proceeds of a foreclosure sale is, however, valid and enforceable. To detach overdue coupons and then pledge the bonds for a debt does not defeat the claim to have the coupons paid first. There is no presumption that the detached coupons are cancelled or destroyed or treated as paid.[54]

§ 249. Coupons which bondholders presented for payment, and had reason to suppose were paid by the company, are not entitled to share in the proceeds of sale as against such bondholders, although they were in fact taken up by one who advanced the money under an agreement that they were to be delivered to him uncan-

[52] Dunham v. Cincinnati &c. R. Co. 1 Wall. (U. S.) 254; Duncan v. Mobile &c. R. Co. 3 Woods (U. S.), 567. Consequently money loaned to pay interest coupons should not be repaid in preference to the mortgage. Contract &c. Co. v. Continental Trust Co. 108 Fed. 1.

[53] Dunham v. Cincinnati &c. R. Co. 1 Wall. (U. S.) 254.

[54] Rhawn v. Edge Hill Furnace Co. 201 Pa. St. 637; 51 Atl. 360.

celled, as security for the advances.[55] The bondholders have a direct interest in having the coupons paid, so as to preserve the value of their security. They delivered them up to the company for payment, and supposed they were paid. If they had known the true state of the case, they might have refused to assign the coupons, and thus, by allowing an accumulation of interest, to have impaired the value of their security. They could have caused a foreclosure of the mortgage for a default in the payment of interest. The court regards the position of the bondholders who have presented their coupons and received payment in this way as being equally strong as if they had purchased their bonds in the belief that the coupons had actually been paid. As against such purchasers there could be no question that the person who had advanced the money for the coupons would be estopped from claiming that he took a transfer of them.[56]

Of course the mortgage remained a security for the payment of the coupons until paid, whether detached or not. As against the railroad company, the persons who advanced money for the coupons in this way could enforce the mortgage. The company had not paid the coupons, and was in no way harmed by their payment by a third person under this arrangement; but the bondholders never agreed that he should take and hold the coupons, and they did not agree that he should have any interest in the mortgage security. The mortgage security proving insufficient to pay the entire debt, their equity is superior to the equity of the party who advanced the money; and as against their equity he cannot be subrogated to the claim under the mortgage.

Coupons will be regarded as paid when they have been called in and cancelled by a promoter who is essentially the company, and have been cancelled by mutilation, or by being marked "paid."[57]

§ 250. A corporation which has guaranteed the payment of

[55] Union Trust Co. v. Monticello &c. R. Co. 63 N. Y. 311; 20 Am. R. 541; Virginia v. Chesapeake &c. Canal Co. 32 Md. 501; Cameron v. Tome, 64 Md. 507; 2 Atl. 837; South Covington &c. R. Co. v. Gest, 34 Fed. 628; Martin v. Bank, 94 Tenn. 176; 28 S. W. 1097, quoting text.

[56] Haven v. Grand Junction R. &c. Co. 109 Mass. 88.

[57] Wood v. Guarantee &c. Co. 128 U. S. 416; 9 Sup. Ct. 131.

the bonds of another corporation, or the interest on such bonds, cannot, by force of subsequent agreement with that corporation, pay the maturing coupons of such bonds and hold them as a valid lien under the mortgage securing the bonds. The corporation having paid the interest in pursuance of its direct obligation to pay it in case of the default of the principal debtor, it is not entitled to be substituted to the rights of the holders of the interest coupons, because such subrogation would defeat or impair the security of the holders as regards other coupons and the bonds themselves, and would violate the spirit of the contract of guaranty.[58]

§ 251. **But one who has taken up coupons in this way may claim payment for any surplus** left after payment of the bondholders. Although having taken up the coupons due on mortgage bonds of a corporation at its request, upon an understanding between him and the corporation that they were not extinguished as against it, but were to be held by him in place of the persons who presented them, he may be estopped to come forward as a purchaser and assignee of the coupons when the transaction appeared to be a payment of the coupons by the company, and was supposed by its creditors to be a payment of them and not an assignment, and the security proves to be insufficient to pay the entire mortgage debt; yet if there be a surplus of proceeds remaining after full satisfaction of the claims of all the other creditors whose claims were covered by the mortgage, he is not estopped to maintain a claim for the amount of the coupons paid by him, with interest from the date of payment.[59] The only parties who could object to this proceeding would be the other creditors secured by the same mortgage; and when their dividend will not be diminished by allowing the claim of one who has taken up coupons under such an arrangement, there can be no objection to the allowance of the claim. They cannot object to the claim, although the supposed payment of the coupons at maturity may have induced them to make purchases of the bonds, because, having received their entire debt, they cannot be said to have suffered any loss or inconvenience from the mode in which the coupons were taken up.

[58] Child v. New York &c. R. Co. 129 Mass. 170.

[59] Haven v. Grand Junction R. & Depot Co. 109 Mass. 88.

§ 252. But when the transaction is not upon its face a payment, but rather a transfer, as, for instance, when the coupons are not redeemed by the corporation that made them, or at its office or other place where the coupons are made payable, there is no presumption of the payment and extinguishment of the coupons. When, therefore, a corporation which had previously paid its coupons at its own office directs the holders to take the coupons to a bank where they would receive payment, and the holders there received the amounts due on the coupons and left them in the possession of the bank, they might properly presume that the company was not paying the coupons. Inasmuch as the holders of the coupons received from the corporation no checks upon the bank, they must have known that the bank had no vouchers for its payments unless the coupons continued in force after the bank received them; and hence it is regarded as a fair presumption that, when they delivered the possession, they assented to a transfer of ownership.[60]

[60] Ketchum v. Duncan, 96 U. S. 659, 662. This case is clearly distinguished from cases like those in the preceding section, where the coupons were paid at the company's office, or with money advanced to the company for the purpose. Yet four of the justices of the court dissented, on the ground that the holders had no thought of selling the coupons, and therefore in law did not sell them. The decision of the court is, however, regarded as sound. "Interest coupons," says Mr. Justice Strong, delivering the judgment of the Supreme Court of the United States, "are instruments of a peculiar character. The title to them passes from hand to hand by mere delivery. A transfer of possession is presumptively a transfer of title. And especially is this true when the transfer is made to one who is not a debtor, to one who is under no obligation to receive them or to pay them. A holder is not warranted to believe that such a person intended to extinguish the coupons when he hands over the sum called for by them and takes them into his possession. It is not in accordance with common experience for one man to pay the debt of another without receiving any benefit from his act. We cannot close our eyes to things that are of daily occurrence. It is within common knowledge that interest coupons, alike those that are not due and those that are due, are passed from hand to hand, the receiver paying the amount they call for without any intention on his part to extinguish them, and without any belief in the other party that they are extinguished by the transaction. In such a case, the holder intends to transfer his title, not to extinguish the debt. In multitudes of cases,

§ 253. **The question whether in a particular transaction there has been a payment or a purchase of the coupons is one of fact,** rather than of law. It is a question of the intention of the parties. In the case under consideration, a purchase rather than a payment was inferred from the circumstances shown, namely, that the persons alleged to have paid the coupons had no connection with the company issuing the coupons; that they had repeatedly and publicly notified the holders of the bonds and coupons that the coupons were to be purchased, not paid; and the coupons were carefully secured and preserved uncancelled.[61] Uncancelled coupons which have in fact been taken up by parties who advanced money for the purpose to an embarrassed corporation, are held under the security of the mortgage, although the company's officers in its books made entries of them as having been paid.[62]

Where, on the other hand, it appeared that the coupons were taken up by one who was the promoter of the company and largely interested in it, that he had instructed his agents to call in the coupons as if for payment, and that many of them were cancelled by him as paid, a finding that the coupons had been paid will not be disturbed.[63] The same conclusion was reached where the holders of

coupons are transferred by persons who are not the owners of the bonds from which they have been detached. To hold that in all these cases the coupons are paid and extinguished, and not transferred or assigned, unless there was something more to show an assent of the person parting with the possession that they should remain alive, and be available in the hands of the person to whom they were delivered, would, we think, be inconsistent with the common understanding of business men."

Cited with approval in Wood v. Guarantee Trust &c. Co. 128 U. S. 416; 9 Sup. Ct. 131; Central Trust Co. v. Cincinnati, J. & M. R. Co. 58 Fed. 500. See, also, Duncan v. Mobile &c. R. Co. 567.

[61] Ketchum v. Duncan, 96 U. S. 659; Wood v. Guarantee Trust &c. Co. 128 U. S. 416; 9 Sup. Ct. 131; 5 Railw. & Corp. L. J. 114, per Lamar, J., Baker v. Meloy, 95 Md. 1; 51 Atl. 893. The owner must have intended a sale. Venner v. Farmers' &c. Co. 90 Fed. 348.

[62] Hand v. Savannah &c. R. Co. 17 S. C. 219.

[63] Wood v. Guarantee Trust &c. Co. 128 U. S. 416; 9 Sup. Ct. 131. See Hollister v. Stewart, 111 N. Y. 644; 19 N. E. 782, where the coupons were paid by contractors for the construction of a railroad, who had agreed to receive in payment the whole issue of first mortgage bonds of the company and the earnings of the road during construction.

bonds had declared their unwillingness to sell coupons, and payment was made at the office of the trustee by its fiscal agent, who was largely interested in preventing a default. A purchaser in good faith of such coupons was not entitled to share with the bondholders in the proceeds of a foreclosure sale.[64]

§ 254. Money deposited by a corporation with a banker in trust, to pay interest coupons on its bonds, is not liable to attachment in a suit against the corporation by a creditor. Money so deposited is appropriated to the benefit of the holders of the coupons of such bonds, and they may enforce the trust.[65]

§ 255. Funded interest bonds.—If a corporation, being unable to pay the interest coupons on its bonds, gives to the holders its coupon bonds for the amount of the overdue interest, this does not presumptively amount to a novation of the debt for interest, but this is still secured by the mortgage securing the original mortgage bonds. The mere change of the evidence of debt does not destroy the lien which had been given for its security. There must be clear proof of intention on the part of those who took the funded interest bonds to release the lien of the original mortgage. The acceptance of the funded interest bonds does not in itself amount to an extinguishment of the debt evidenced by the coupons.[66]

IV. *Interest on Overdue Coupons and Bonds.*

§ 256. Interest is recoverable upon coupons after their maturity by way of damages for the detention of money due, and should be computed at the lawful rate without semi-annual or other rests.[67]

[64] Baker v. Meloy, 95 Md. 1; 51 Atl. 893.

[65] Rogers Locomotive Works v. Kelly, 19 Hun (N. Y.), 399. See Pettibone v. Toledo &c. R. Co. 148 Mass. 411; 19 N. E. 337; 1 R. L. A. 787n.

[66] Gibert v. Washington City &c. R. Co. 33 Gratt. (Va.) 586; Jones Mortgages, §§ 924–927.

[67] Genoa v. Woodruff, 92 U. S. 502; Walnut v. Wade, 103 U. S. 683; Koshkonong v. Burton, 104 U. S. 668; Huey v. Macon County, 4 Railw. & Corp. L. J. 427; Aurora City v. West, 7 Wall. (U. S.) 82, 105; Cromwell v. Sac, 96 U. S. 51; Hollingsworth v. Detroit, 3 McLean (U. S.), 472; Gelpcke v. Dubuque, 1 Wall. (U. S.) 175; Ashue-

Such interest will be computed only at the legal rate, even where the rate of interest on the bonds themselves after maturity continues at a higher rate which the parties are allowed under the statutes to contract for, the statutory rate applying only in the absence of a

lot R. Co. v. Elliott, 57 N. H. 397; Langston v. So. Carolina R. Co. 2 S. C. 248; Beaver v. Armstrong, 44 Pa. St. 63; Philadelphia &c. R. Co. v. Smith, 105 Pa. St. 195; Philadelphia &c. R. Co. v. Knight, 124 Pa. St. 58; 16 Atl. 492; 5 Railw. & Corp. L. J. 574; Virginia v. Chesapeake &c. Canal Co. 32 Md. 501; North Pa. R. Co. v. Adams, 54 Pa. St. 94; 93 Am. Dec. 677; Mills v. Jefferson, 20 Wis. 50; Arents v. Commonwealth, 18 Gratt. (Va.) 750, 776; Burroughs v. Richmond County, 65 N. C. 234; Connecticut &c. Ins. Co. v. Cleveland &c. R. Co. 41 Barb. (N. Y.) 9; 26 How. Pr. 225; McLendon v. Anson County, 71 N. C. 38; Davis v. Yuba, 75 Cal. 452; 13 Pac. 874; 17 Pac. 533; Welsh v. St. Paul &c. R. Co. 25 Minn. 314; Gibert v. Washington City V. M. & G. S. R. R. Co. 33 Gratt. (Va.) 586; Fox v. Hartford, &c. R. Co. 70 Conn. 1; 38 Atl. 871; Harper v. Ely, 70 Ill. 581; Harper v. Ely, 56 Ill. 179; Humphreys v. Morton, 100 Ill. 592; United States Mort. Co. v. Sperry, 138 U. S. 313, 340; 11 Sup. Ct. 321; Trustees of Int. Imp. Fund v. Lewis, 34 Fla. 424; 16 So. 325; 26 L. R. A. 743; Rice v. Shealey, 71 S. C. 161; 50 S. E. 868; Nesbit v. Independent Dist. 144 U. S. 610; 12 Sup. Ct. 746. **New York** and **Colorado** hold otherwise. "Interest, as a rule, follows the principal without becoming principal, and cannot be compounded by force merely of the contract; but that general rule has been modified somewhat by an exception growing out of the character and purpose of interest coupons. They may become separate and independent instruments. When they do the exception is for the first time needed and for the first time applies. Before that occurs and while they remain in the hands of the holder of the bonds the occasion for the exception has not arisen and the exception does not apply." Williamsburgh Sav. Bank v. Solon, 136 N. Y. 465; 32 N. E. 1058; 65 Hun (N. Y.), 166; 20 N. Y. S. 27; per Finch, J. In Bailey v. Buchanan, 115 N. Y. 297; 22 N. E. 155; 6 R. L. A. 562n, reversing 22 J. & S. (N. Y.) 237. Earl, J., referring to coupons, said: "Until negotiated or used in some way they serve no independent purpose; while they are in the hands of the holder they remain mere incidents of the bonds and have no greater force or effect than the stipulation for the payment of interest contained in the bonds; and while they continue in such ownership and possession it can make no difference whether they are attached or detached, as they are then mere evidences of the indebtedness for the interest stipulated in the bonds." Followed in Lake County v. Linn, 29 Colo. 446; 68 Pac. 839; Columbus &c. R. Co., Appeals of, 109 Fed. 177.

different stipulated rate.[68] The laws of the state in which the coupons are payable would ordinarily determine the rate of interest payable upon overdue coupons; but in an action upon coupons in the state where the corporation was organized and the bonds were issued, though they are made payable in another state, in the absence of proof of the rate of interest in the latter state, interest will be allowed according to the legal rate in the former state.[69]

A bond payable at a fixed time and place on the surrender of the bond bears interest from its maturity, although no demand of payment, or offer to surrender the bond, be made.[70] This principle has been long established, though there is some difference of opinion whether the interest follows as a part of the contract, by the recognized rule appertaining to the breach of a written promise to pay a named sum at a fixed period, or as compensation, in the way of damages, for the detention of the debt. Some cases hold, however, that if a bond be made payable on demand at a particular place, no default of payment could be averred without a compliance with the condition precedent of making demand; and consequently there can be no recovery of interest except from the time of a demand.[71]

The owner of lost coupons is entitled, upon tendering indemnity, to recover the amount of them, with interest from the date of demand and tender of indemnity.[72]

Interest upon the coupons of the Chesapeake and Ohio Canal Company was not allowed as against the State of Maryland, which, having a prior lien upon the property, waived it in favor of the bonds, "so as to make the said bonds and the interest to accrue

[68] Cromwell v. Sac, 96 U. S. 51, 62.

[69] Huey v. Macon County, 4 Railw. & Corp. L. J. 427.

[70] Walnut v. Wade, 103 U. S. 683; Ohio v. Frank, 103 U. S. 697; Langston v. South Carolina R. Co. 2 S. Car. 248; Spencer v. Pierce, 5 R. I. 63; Virginia v. Chesapeake &c. Canal Co. 32 Md. 501; San Antonio v. Lane, 32 Tex. 405; North Pennsylvania R. Co. v. Adams, 54 Pa. St. 94; 93 Am. R. 677; Jeffersonville v. Pattersonville, 26 Ind. 15; 89 Am. Dec. 448.

[71] Aurora City v. West, 7 Wall. (U. S.) 82, 105; Gelpcke v. Dubuque, 1 Wall. (U. S.) 175, 206; Corcoran v. Chesapeake &c. Canal Co. 1 McArthur (D. C.), 358; Whitaker v. Hartford &c. R. Co. 8 R. I. 47; 5 Am. R. 547; Pekin v. Reynolds, 31 Ill. 529, 531; 83 Am. Dec. 244; Chicago v. People, 56 Ill. 327.

[72] Fitchett v. North Pennsylvania R. Co. 5 Phila. (Pa.) 132.

thereon preferred and absolute liens," until the bonds and interest should be fully paid. This waiver was construed to extend only to the principal and interest of the bonds, so that interest on the overdue coupons could not be paid until the lien of the state had been satisfied.[73]

§ 257. **In like manner where, by the terms of the mortgage, bonds to a certain amount are to be called or drawn** for redemption semi-annually, and to be paid from a sinking fund before the time fixed for the final redemption of the mortgage, if bonds are drawn and remain unredeemed through failure of the mortgagor to provide funds, interest continues to run upon these bonds up to the time of their payment. And where, in such a case, default having been made, the trustees took possession and afterwards had funds, out of which they proposed to pay interest only on the undrawn bonds, they were enjoined from so doing, and directed to apply the funds in the first place in payment of interest, *pari passu,* on undrawn bonds, and on drawn bonds which remained unpaid through the failure of the borrowers to provide funds.[74]

§ 258. **If a corporation has no funds at the place** at which the coupons of its bonds are to be presented for payment, interest is payable on the coupons after maturity without presentation. To make available a defence of readiness to pay the coupons at the time and place they were payable, it must be alleged, and inasmuch as such a plea is affirmative, it casts the burden of proof upon the defendant.[75] If, however, the corporation has money at the time and place fixed for the payment of its coupons sufficient to pay them and all other maturing obligations, it is not necessary for the company, in order to escape after-accruing interest, to show that the money for the payment of its coupons was kept separate from the other funds of the company.[76]

It is not necessary to present a coupon for payment at a place

[73] Corcoran v. Chesapeake &c. Canal Co. 1 McArthur (D. C.), 358.

[74] Gordillo v. Weguelin, L. R. 5 Ch. D. 287.

[75] North Pennsylvania R. Co. v. Adams, 54 Pa. St. 94; 93 Am. Dec. 677; Marlor v. Texas &c. R. Co. 21 Fed. 383.

[76] Emlen v. Lehigh Coal &c. Co. 47 Pa. St. 76; 86 Am. Dec. 518n.

named as a condition precedent to a recovery of judgment upon it against the maker.[77]

Coupons payable at a particular office are like notes payable at a specified bank, and import that the debtor will have a deposit at the time and place specified to pay them with. Unless it be shown that a fund was so provided, it is no defence to allege a want of demand.[78] In North Carolina, contrary to the general rule, it is held that in an action against the bond of commissioners of a county a demand is necessary, not to fix the liability, but simply to give notice of the liability, and an opportunity to pay without suit.[79]

A demand of payment of interest due upon bonds at the place where they are made payable by the holder is sufficient without any demand by the trustee.[80]

§ 259. **A corporation is not bound to seek its creditors in a foreign country,** unless it has agreed so to do; and therefore a foreign bondholder, or a resident bondholder who is absent from the country, cannot compel the company to pay interest on overdue coupons, or upon the loan after it has fallen due, in the absence of all proof of inability or want of readiness to pay them at the time and place they were made payable.[81]

§ 260. **According to some authorities the rate of interest recoverable after maturity,** upon a bond not providing for the rate after the debt becomes due, is that fixed by law for cases where the parties have not agreed upon a rate, although the rate which the bond bears upon its face before maturity be either higher or lower than the legal rate.[82] But a different rule has been declared by some

[77] Smith v. Tallapoosa County, 2 Woods (U. S.), 514.

[78] Philadelphia &c. R. Co. v. Johnson, 54 Pa. St. 127.

[79] Alexander v. McDowell, 67 N. C. 330; McLendon v. Anson County, 71 N. C. 38.

[80] Taber v. Cincinnati &c. R. Co. 15 Ind. 459.

[81] Emlen v. Lehigh Coal &c. Co. 47 Pa. St. 76; 86 Am. Dec. 518n.

[82] Brewster v. Wakefield, 22 How. (U. S.) 118; Langston v. South Carolina R. Co. 2 S. C. 248; Virginia v. Chesapeake &c. Canal Co. 32 Md. 501; Lash v. Lambert, 15 Minn. 416; 2 Am. R. 142; Searle v. Adams, 3 Kans. 515; 89 Am. Dec. 598; Pearce v. Hennessy, 10 R. I. 223; Eaton v. Boissonnault, 67 Me. 540; 24 Am. R. 52; Rilling v. Thompson, 12 Bush (Ky.), 310.

courts, and the weight of authority supports the rule that the rate of interest stipulated in the bond attends the contract until it is merged in judgment.[83] It is doubtful whether the Supreme Court of the United States would now follow the case of Brewster v. Wakefield, under like circumstances, although there is a clear distinction between that and the later case of Cromwell v. County of Sac. The former case arose under a statute of the Territory of Minnesota, which allowed parties to agree upon any rate of interest, and prescribed seven per cent. in the absence of such agreement. The court, bound by no adjudication of the territorial court, and looking with disfavor upon the exorbitant interest stipulated for in that case, gave a strict construction to the contract of the parties, saying: "When a party desires to extort, from the necessities of a borrower, more than three times as much as the legislature deems reasonable and just, he must take care that the contract is so written in plain and unambiguous terms; for with such a claim he must stand on his bond." The case of Cromwell v. County of Sac arose under a statute which fixed the legal rate of interest at six per cent., but allowed parties to agree in writing for a rate not exceeding ten per cent., and provided that a judgment upon the contract should bear the same rate. The bonds in question bore interest at the rate of ten per cent., and the court held that they drew the same rate after maturity. In this decision the Supreme Court followed the adjudications of the state courts. The argument also was conclusive that, as a judgment in case of a stipulated interest must bear the same rate, it could not have been intended that a different rate should be allowed between the maturity of the contract and the entry of the judgment. Moreover, the limitation of ten per cent., within which the parties may agree for interest, relieves the court from

It is a general and well established rule that interest bearing coupon bonds continue to bear interest after their maturity. Kendall v. Porter, 120 Cal. 106; 45 Pac. 333; 52 Pac. 143.

[83] Brannon v. Hursell, 112 Mass. 63; Cromwell v. Sac, 96 U. S. 51; Beckwith v. Hartford &c. R. Co. 29 Conn. 268; 76 Am. Dec. 599; Marietta Iron Works v. Lottimer, 25 Ohio St. 621; Etnyre v. McDaniel, 28 Ill. 201; Pruyn v. Milwaukee, 18 Wis. 367; Hand v. Armstrong, 18 Iowa, 324; Kohler v. Smith, 2 Cal. 597; 56 Am. Dec. 369; McLane v. Abrams, 2 Nev. 199; Hopkins v. Crittenden, 10 Tex. 189; People v. Getzendaner, 137 Ill. 234; 34 N. E. 297.

sanctioning an extravagant and unreasonable agreement for interest.

The doctrine of the English decisions is, that after the maturity of a mortgage or mortgage bond, when the money for the payment of the debt has not been provided for at the place of payment, interest will run on at the old rate up to the time of redemption. What is paid for interest after maturity may be technically called damages, but it is damages of a peculiar kind, for it would not be left to a jury to regulate their amount; the jury would be directed as a matter of law to find damages of the same amount as the interest, which would have been payable if the covenant had extended over this period.[84] There may, perhaps, be an exception to this rule when the agreed rate of interest is excessive and extraordinary; and when the court would adopt the statute rate of interest after maturity, as damages for the breach of the condition.[85]

V. *Suits upon Coupons.*

§ 261. A holder of negotiable coupons may sue and recover upon them without producing or being interested in the bonds from which they were detached.[86] The declaration need not recite the bond from which the coupons were cut, though it is proper in some cases to show the relation which the coupons originally bore to the bond.[87] Several coupons may be declared upon in a single count, distinguishing them by a reference to the numbers of the bonds to which they belonged.[88]

[84] Gordillo v. Weguelin, L. R. 5 Ch. D. 287, per Amphlett, P.; Morgan v. Jones, 8 Ex. 620; Price v. Great Western R. Co. 16 M. & W. 244.

[85] Cook v. Fowler, L. R. 7 H. L. 27.

[86] Thomson v. Lee County, 3 Wall. (U. S.) 327; City v. Lamson, 9 Wall. (U. S.) 477; Carr v. Le Fevre, 27 Pa. St. 413; Society for Savings v. New London, 29 Conn. 175; Johnson v. Stark, 24 Ill. 75.

[87] City v. Lamson, 9 Wall. (U. S.) 477; Ring v. Johnson, 6 Iowa, 265. In Maine it is provided by statute that when coupons for interest are issued with bonds, and, for a valuable consideration, are detached and assigned by delivery, the assignees may maintain assumpsit upon them in his own name against the corporation engaging to pay them. R. S. 1871, p. 454.

[88] New London National Bank v. Ware River R. Co. 41 Conn. 542.

Neither does it make any difference that the bond itself has been paid, when demand is made or suit commenced upon a negotiable coupon in the usual form detached from it. When the coupon is detached from the bond it loses its character as a mere incident to the bond, and becomes an independent claim, and therefore the payment of the bond could have no effect upon the coupon previously detached. The action is not upon the bond, but upon the coupon as separated from the bond. A special count of a declaration setting forth the bond by way of inducement, but founding the cause of action upon a coupon, and averring that it had been detached before the bond was paid, and that it was subsequently presented for payment and payment refused, is not, probably, open to objection; but at any rate a general count in debt is not.[89] It may sometimes be necessary to resort to the bond to prove the execution of the coupon; but when it contains a promise of payment to bearer, it is an independent negotiable instrument, and the cancellation of the bond has no effect upon it. Furthermore, where an action is brought upon coupons, it is not necessary to prove the execution of the mortgage securing the bonds to which the coupons were attached.[90]

But in a suit upon coupons of municipal bonds which could be issued only by virtue of legislative authority, that authority should appear either by distinct averment of the specific act conferring it, or by stating the recital of the bond in that respect. The coupons, though detached, are related to the bonds to which they originally

[89] Thomson v. Lee County, 3 Wall. (U. S.) 327; Spooner v. Holmes, 102 Mass. 503; 3 Am. R. 491; National Exchange Bank v. Hartford &c. R. Co. 8 R. I. 375; 5 Am. R. 582; Miller v. Berlin, 13 Blatchf. (U. S.) 245, 250; Cooper v. Thompson, 13 Blatchf. (U. S.) 434, 438; Trustees of Int. Imp. Fund v. Lewis, 34 Fla. 424; 16 So. 325; 26 L. R. A. 743; 43 Am. St. 209; Fox v. Hartford &c. R. Co. 70 Conn. 1; 38 Atl. 871. Where coupons long overdue are found in the possession of the president of the corporation issuing the bonds, it cannot be assumed that he paid them out of his own means, it appearing that the corporation had at all times a large bank balance and that the coupons were paid in the ordinary course of business. Lloyd v. Wagner, 93 Ky. 644; 21 S. W. 334. Coupons in the possession of the corporation are presumed to be paid, but this presumption may be rebutted. Kelly v. Forty-Second St. R. Co. 37 App. Div. (N. Y.) 500; 55 N. Y. S. 1096.

[90] Conshohocken Tube Co. v. Iron Car Equipment Co. 161 Pa. St. 391; 28 Atl. 1119.

belonged, and by way of inducement or recital this relation ought to appear on the face of the declaration or petition.[91] It is not necessary, however, to set out the vote or election provided for under the statute preliminary to the issuing of the bonds and coupons.[92]

In a suit upon coupons payable at a particular place, it is not necessary to aver or prove a presentation of them there for payment.[93] If the corporation that made the coupons had money ready at the time and place of payment, this fact may be shown in defense to a claim for interest on the coupons.[94]

§ 262. Coupons which contained no negotiable words, nor any language from which it can be inferred that the intention was to make them negotiable, cannot be enforced in the name of an assignee.[95] Such coupons can be enforced only in the name of the bondholder. He would be bound to enforce the coupons in behalf of the person to whom he had thereby transferred a portion of his interest in the bond: but the nature of the contract as a mere right of action is not changed by the transfer.[96]

A coupon which is not negotiable is equally a part of the mortgage debt, and an assignment of it carries with it by implication an interest in the mortgage security; only the assignee would be obliged to seek payment of it in the name of the person to whom it was issued.[97]

An interest warrant which does not import a promise, but is a mere acknowledgment of indebtedness for interest on the bond itself, cannot generally be made the ground of an action.[98] When the

[91] City v. Lamson, 9 Wall. (U. S.) 477; Kennard v. Cass County, 3 Dill. (U. S.) 147; Thayer v. Montgomery County, 3 Dill. (U. S.) 389. See, however, Ring v. Johnson, 6 Iowa, 265.

[92] See §§ 287–299 of Chapter vii. of 1st Ed.; Underhill v. Sonora, 17 Cal. 172.

[93] Greene v. Daniel, 102 U. S. 187; Walnut v. Wade, 103 U. S. 683; Wallace v. McConnell, 13 Pet. (U. S.) 136; Irvine v. Withers, 1 Stew. (Ala.) 234; Montgomery v. Elliott, 6 Ala. 701; Warner v. Rising Fawn Iron Co. 3 Woods (U. S.), 514.

[94] Wallace v. McConnell, 13 Pet. (U. S.) 136; Walnut v. Wade, 103 U. S. 683; North Pennsylvania R. Co. v. Adams, 54 Pa. St. 94; 93 Am. R. 677.

[95] Jackson v. York &c. R. Co. 48 Me. 147.

[96] Wright v. Ohio &c. R. Co. 1 Dis. (Ohio) 465.

[97] Sewall v. Brainerd, 38 Vt. 364.

[98] Crosby v. New London &c. R. Co. 26 Conn. 121. The interest war-

right of interest is founded upon the bond itself, the declaration should be specially upon that. Thus, if the bond be made payable to bearer, with semi-annual interest thereon payable at the office of the company on delivery of certain interest warrants annexed, which imply no promise of payment in themselves, no one but the holder of the bond can maintain an action for the interest. The form of the instrument shows that the interest warrants were not intended to be additional or collateral promises or securities for the payment of interest, but that they were devised only as convenient and safe vouchers, furnishing the company evidence of payment, and for the bondholder superseding the necessity or trouble of presenting the bond itself for the payment of the interest due upon it.

An interest coupon, or warrant in the form of an order, doubtless imports a promise, and of itself is a ground of action.[99] Though the majority of the bondholders waive the payment of interest for a series of years and agree to fund the coupons, the dissenting bondholders may sue in assumpsit for the amount of their unpaid coupons at any time after their maturity.[100]

§ 263. When by the terms of a mortgage the coupons are payable only from the net revenues of the company, in a suit upon them it is necessary to allege and prove the existence of such revenues before there can be any recovery. Unless revenue comes into the treasury of the company, the bondholders cannot claim its appropriation to the payment of the coupons. A demand for payment when, without the company's fault, there are no revenues on hand to meet the coupons, is premature, and properly refused; therefore, in such case interest is not recoverable upon the coupons from the time of such demand, but only from a demand when there are such revenues and an unjust refusal.[101]

Where bonds contain an absolute promise to pay interest on cer-

rant was in the following form: "Interest Warrant. Mortgage and Convertible Bond. For thirty dollars, being half yearly interest on Bond No. 30 of the New London, Williamantic, and Palmer Railroad Co., payable on the first day of February, 1856. John Dickinson, Treasurer. $30."

[99] Queensbury v. Culver, 19 Wall. (U. S.) 83.

[100] Manning v. Norfolk &c. R. Co. 29 Fed. 838.

[101] Corcoran v. Chesapeake &c. Canal Co. 1 McArthur (D. C.), 359.

tain days specified, followed by the stipulation, "Said interest shall be cumulative, and if any of the payments cannot be made on the dates named, all interest due shall be paid as soon thereafter as sufficient money has been earned to enable the company to do so," this stipulation may afford a defence to the company, if it can show that income has not been earned. But such words cannot be regarded as constituting the earning of income a condition precedent to the maintaining of an action on the coupons, or as imposing the burden of proof upon the holder of the bond.[102]

§ 264. There is prima facie a right of action for interest due, though a privilege is reserved to issue scrip for the interest whenever the company's earnings are insufficient to pay it. Whether the net earnings are sufficient to pay the interest or not is a fact peculiarly within the knowledge of the company, and it is not incumbent upon the bondholder to prove the negative. He is not bound to accept the scrip unless the fact exists which authorizes the defendant to substitute scrip for money. His right of action is *prima facie* perfect upon proof of non-payment of interest on the presentment of the bond at the place where the interest is made payable. It then devolves upon the company to show the existence of the fact which authorizes it to tender scrip, and the exercise of the option.[103]

An option reserved in a bond to pay interest in scrip, if the net earnings of a portion of the mortgaged road should prove to be insufficient for the payment of the interest, must be exercised by the company on the day the interest becomes due; and in the absence of an exercise of such option, a coupon-holder has an immediate right of action for the interest, and may refuse to accept the scrip.[104]

[102] Strauss v. United Telegram Co. 164 Mass. 130; 41 N. E. 57.

[103] Marlor v. Texas &c. R. Co. 19 Fed. 867.

[104] Texas &c. R. Co. v. Marlor, 123 U. S. 687; 8 Sup. Ct. 311, 318, affirming Marlor v. Texas &c. R. Co. 19 Fed. 867; 21 Fed. 383; 22 Blatchf. (U. S.) 464; 3 Railw. & Corp. L. J. 136. Blatchford, J., delivering the opinion of the Supreme Court, said: "It is plain that the option of the company to issue the scrip must be exercised at the time when, but for the insufficiency of the net earnings, it would be required to pay the interest in money. If the option be thus exercised, reasonable time may be allowed to prepare the scrip and issue and deliver it."

§ 265. A corporation that has issued bonds payable out of income or surplus earnings is subject to a suit for an accounting to a bondholder, and a decree may be entered against it for the payment of the income applicable to the interest. Such a corporation owes a duty to the bondholder to keep such an account of its earnings and expenses as will show the net results of each interest period, when such bonds are secured by a mortgage, and the mortgage trustee owes an active duty to the bondholders to supervise the account. If no account has been kept for a series of years, upon an accounting in court the holders of coupons are entitled to have the interest earned during each interest period applied upon the coupons representing that period.[105]

A provision in a mortgage bond that "no more interest shall be payable by virtue hereof than shall be certified by a vote of a majority of the board of directors for the time being to have been by said corporation earned over and above *all expenses*." was held to defeat the bondholders' right to an accounting. The obligation to pay the principal of the bonds at maturity was absolute, but it assumed to pay the interest only out of the earnings of the company. The *proviso* had two general purposes—to limit the scope of the prior general covenant to pay interest, and to constitute the directors the tribunal to determine whether there were earnings applicable to the payment of interest. The contract did not operate as an equitable assignment of the fund designated to the bond creditors or create an equitable lien in their favor. If the directors wrongfully refused to certify, when there was a surplus applicable to the payment of interest, an action would lie against the corporation in behalf of the bondholders for damages, but not for an accounting.[106]

§ 266. The fact that the interest of bonds is payable out of the net income does not restrict the company from changing the condition of the property, by additions, extensions, and improvements consistent with the purposes of its incorporation; and where the mortgage securing the bond provided that, whenever the com-

[105] Barry v. Missouri &c. R. Co. 27 Fed. 1; 4 Railw. & Corp. L. J. 198; Mackintosh v. F. &c. R. Co. 34 Fed. 582.

[106] Thomas v. New York &c. R. Co. 139 N. Y. 163; 34 N. E. 877.

pany should acquire any franchises, or "property or interests of any name or nature, for the use of or in connection with its railroad," they should be subject to the lien of the mortgage, the implication, on the contrary, is that the parties contemplated that the line of road should be made active and efficient, and that additions, extensions, and improvements should be made in the discretion of the company's directors. Consequently the income bondholders cannot restrain the company from using its earnings for the purpose of paying the rent of a lease of another road taken by the company after the issuing of the bonds.[107]

It may, however, be incumbent upon the officers of the road to keep separate accounts of the earnings and expenses of that part of the company's lines specifically described in the mortgage, the income of which is pledged to the bondholders. Thus, where an income mortgage of a company's system of roads provided that the board of directors should each year declare the amount of the net earnings applicable to the payment of interest on the bonds, and that the adjudication of the board as to the net income should be final and conclusive as an award, and that no right of action should exist in favor of any bondholder for interest until the same should be adjudged and awarded by the board, the company subsequently acquired additional lines of road. The earnings and expenses of the original lines and of the new lines were kept conjointly as a single account. The board of directors, without endeavoring to ascertain whether net income had been earned by the original lines, resolved that no income had been earned applicable to interest. In an action by a bondholder alleging that interest was payable and for an accounting, it was held that the company could not charge against the income of the original lines the expenses or losses incurred in operating the new lines; and that the fact that no award of interest had been made by the board of directors was not a defence to the action.[108]

§ 267. The plea of the statute of limitations is not a good de-

[107] Day v. Ogdensburgh &c. R. Co. 107 N. Y. 129; 13 N. E. 765. See, also, Day v. New Lots, 107 N. Y. 148; 13 N. E. 915; Bank v. Seymour, 46 Conn. 156.

[108] Spies v. Chicago &c. R. Co. 40 Fed. 34.

fence to an action upon coupons, when it would not be a good defence to the bonds from which they were cut. They are but repetitions, as respects the interest payable at stated times, of the contract which the bond itself makes on that subject, and are a device for the convenience of the holder in the way of collecting the interest. They do not change the nature of the security given by the bond for the interest. There is really but one contract for the payment of interest, and that is contained in the bond. When the coupons are cut off, they still partake of the security of the bond.[109] The bonds are specialties, and so are the coupons, and the same statute of limitations applies to both.[110]

But the statute begins to run against actions upon coupons for interest from the time of their maturity, when they have been detached from the bonds and transferred to others than the holders of the bonds. The coupons themselves give a right of action without the bond, and it would be exceptional and illogical to hold that the statute sleeps with respect to claims upon them, while a complete right of action upon them exists in the holder. Therefore, where a statute of limitations extends the same limitation to actions upon all written contracts, sealed or unsealed, it begins to run against coupons from their maturity, so that in such case an action upon the coupons would become barred before an action upon the bonds themselves maturing at a later date would be barred.[111]

[109] Kenosha v. Lamson, 9 Wall. (U. S.) 477.

[110] Bradfoot v. Fayetteville, 124 N. Car. 478; 32 S. E. 804.

[111] Clark v. Iowa City, 20 Wall. (U. S.) 583, 588. Referring to the previous decisions by the Supreme Court of the United States upon this point, Mr. Justice Field said: "It was not the intention of the court to decide that an action upon a coupon detached from the bond, and negotiated to other parties, was not subject to the same limitations as an action upon the bond itself; much less to hold that the coupons remained a valid and existing cause of action, not only for the period prescribed for actions on the bond after its maturity, but for the additional period intervening between the maturity of the coupon and the maturity of the bond, however great that might be. The question before the court in those cases was only whether the time the statute had to run against the coupons was the longest or shortest period (was it six or twenty years in the Wisconsin case, or was it five or fifteen years in the Kentucky case); and the court held that the statute ran for the longest period, because the cou-

A similar case arose under the statute of limitations of Kentucky, which prescribed fifteen years as the limitation for actions upon bonds, and only five years for actions on simple contracts. The action was upon coupons of certain bonds issued by the city of Lexington, and the city set up the statute of limitations of five years in defence; but the Supreme Court of the United States answered that bonds are specialties not falling within the period prescribed; that suits on the bonds might be maintained if commenced within fifteen years after the cause of action accrued; and that a suit on a coupon is not barred by the statute unless the lapse of time be sufficient to bar also a suit upon the bond, as the coupon is but a repetition of the bond in respect to the interest for the period of time therein mentioned, and partakes of its nature.[112]

pons partook of the nature of the bonds and the statute ran for that period as to them." See, also, Amy v. Dubuque, 98 U. S. 470; Koshkonong v. Burton, 104 U. S. 668.

[112] Lexington v. Butler, 14 Wall. (U. S. 282; McCoy v. Washington Co. 3 Wall. (U. S.) Jr. 381.

CHAPTER IX.

CONTRACTS OF GUARANTY AND INDORSEMENT.

I. Nature of the contracts of guaranty and indorsement, §§ 268–279.

II. Corporations cannot enter into the contract without legislative authority, §§ 280–286.

I. *Nature of the Contracts of Guaranty and Indorsement.*

§ 268. **The contract of a guarantor is collateral, secondary, and contingent.** It binds him to pay the debt guaranteed, if by the exercise of due diligence it cannot be collected from the principal debtor. The contract of surety is on the other hand direct, and makes him responsible at once upon the default of the principal debtor. The contract of an indorser of a negotiable instrument is different from either. He undertakes to pay the obligation, in case of its dishonor, if it is duly presented for payment to the maker at maturity, and due notice is given to him of its dishonor, but not otherwise. His contract differs from that of a guarantor chiefly in the matter of making demand upon the maker and giving notice of dishonor; for, while punctual presentment and punctual notice of non-payment are requisite to charge an indorser, in the case of a guarantor presentment and notice within a reasonable time is all that is required, and this reasonable time is ordinarily determined by the inquiry whether, by reason of delay, the guarantor has sustained any loss or injury.

§ 269. **Under a guaranty of a coupon bond the degree of diligence required of the holder** of a coupon is to be ascertained by

reference to the relation of the parties, and to the injury sustained by the guarantor from the delay. This point was well considered in a suit against the State of Virginia upon its guaranty of the negotiable bonds of the city of Wheeling, issued to pay the city's subscription to the stock of the Baltimore and Ohio Railroad Company. A number of coupons for interest due upon these bonds for the years 1862, 1863, and for January, 1864, were stolen from the state, and in November of the latter year were bought in Richmond by one who paid full value for them without knowledge that they had been stolen. After the close of the civil war, in 1865, the purchaser presented them for payment at the banking house in New York where they were made payable, and also to the city of Wheeling; but payment being refused, he brought suit against the State of Virginia upon its guaranty. The city of Wheeling was ready to pay the coupons whenever the question of their ownership should be determined. The Court of Appeals of Virginia held that the state was not liable upon its guaranty of these coupons by reason of the delay in presenting them for payment.[1]

§ 270. A guaranty of bonds without other designation implies a guaranty of the principal sum, and of its incident, the interest.[2] A city having issued bonds to a gas company, under an ordinance providing that the gas company should "guarantee the said bonds, and assume the payment of the principal thereof at maturity," it was held that the ordinance contemplated two undertakings by the company: one to the bondholder to answer for the city's liability;

[1] Arents v. Commonwealth, 18 Gratt. (Va.) 750, 775. Mr. Justice Joynes, delivering the opinion of the majority, said: "The state has a right to claim that they shall be presented for payment within a reasonable time after they become payable, so that it may be relieved from its liability as guarantor; and the coupons on their face give notice of the guaranty. It cannot be supposed that the state would be willing to incur a responsibility wholly indefinite in point of time, which would be the case if the coupons were designed to circulate, without any limit, after the day of payment. It is no answer to say that the city of Wheeling has provided by a mortgage for the indemnity of the state. The security may be lost, or its value impaired by delay; and the state, by accepting that security, did not abandon the character of guarantor and assume that of principal debtor."

[2] New Orleans v. Clark, 95 U. S. 644.

the other to the city to pay the bonds at their maturity. The indorsement of the president of the company on the bonds, guaranteeing "the payment of the principal and interest thereof," was a substantial compliance with the ordinance.[3]

It is a sufficient consideration for a guaranty by one railroad company, of the payment of the interest and coupons of another company, that an arrangement has been entered into between the roads to secure a uniform gauge, and thus increase the business of each.[4]

Under a guaranty of the prompt payment of the principal and interest of coupon bonds, it seems that the guarantor is liable for interest upon coupons detached from the bonds from the time they become payable. The principal is liable for such interest, and as a general rule a surety or guarantor is bound to the same extent as the principal.[5]

§ 271. A guarantor is not bound by a change made in the terms of the bonds after the guaranty. Thus, where bonds of a corporation, as prepared for issue and sale, promised payment in lawful money, but after a guaranty of them made by a state a stipulation was indorsed upon the bonds by the corporation, to meet the requirements of purchasers of the bonds, that they should be paid in coin. Such indorsement was held to bind the corporation only.[6]

§ 272. The principal creditor is in equity entitled to the benefit of bonds of a corporation received by a surety, or by a person standing in the position of a surety, for his indemnity, and to discharge the debt he is liable for; and it makes no difference that the principal creditor did not know of the security at the time, or did not give credit on the faith of it.[7]

A guarantor having paid a part only of the debt of the principal debtor for which the guaranty was given, cannot claim reimburse-

[3] New Orleans v. Clark, 95 U. S. 644.

[4] Connecticut Mut. Life Ins. Co. v. Cleveland &c. R. Co. 41 Barb. (N. Y.) 9.

[5] Philadelphia &c. R. Co. v. Knight, 124 Pa. St. 58; 16 Atl. 492; 5 Railw. & Corp. L. J. 574.

[6] Wallace v. Loomis, 97 U. S. 146.

[7] Rice's Appeal, 79 Pa. St. 168.

ment out of the funds of such debtor as against the common creditor until the latter is fully satisfied.[8]

A guarantor of railroad bonds who has paid the debt is entitled as a creditor to the benefit of a statute authorizing the appointment of a receiver of an insolvent railroad, canal, or turnpike company, upon the application of a creditor, and a sale or lease of the property.[9]

§ 273. **A contract of guaranty of a coupon bond transferable by delivery is itself in effect negotiable** at law with the bond or coupons; for if not actually negotiable through the negotiability of the bonds and coupons, it is assignable with them in equity, and an interest in it passes in equity to each successive holder of the bond or coupons. It is the manifest intention of the parties that the right to enforce the guaranty shall be coextensive with the right to enforce the payment of the debt. The guaranty, as an accessory to the bond or coupon, follows it and adheres to it in equity, and the right to enforce the guaranty must be determined by the right to demand payment of the bond or coupon. Whoever is entitled to enforce the bond or coupon is entitled to enforce the guaranty, and cannot be defeated by any equities that do not affect his claim upon these primary demands.[10]

§ 274. **A guaranty is not provable in bankruptcy or in schemes of liquidation without express provision,** until the liability becomes absolute by the failure of the principal debtor to pay the obligation at maturity according to its terms. Until the liability becomes absolute, there is no way in law or in equity by which a person holding a guaranty can secure himself out of the property of the guarantor. Neither is the holder of bonds guaranteed by a corporation entitled to share as a creditor in a scheme of reorganiza-

[8] Virginia v. Chesapeake &c. Canal Co. 32 Md. 501.

[9] Pennsylvania R. Co. v. Pemberton &c. R. Co. 28 N. J. Eq. 338.

[10] Arents v. Commonwealth, 18 Gratt. (Va.) 750; Blakely Ordnance Co. In re, L. R. 3 Ch. 154; Agra & Masterman's Bank, In re, L. R. 2 Ch. 391, 397; Codman v. Vt. & C. R. Co. 16 Blatchf. (U. S.) 165; And see Partridge v. Davis, 20 Vt. 499; Sanford v. Norton, 14 Vt. 228; 49 Am. Dec. 786; Sylvester v. Downer, 20 Vt. 355; Louisville Trust Co. v. Lousiville &c. R. Co. 75 Fed. 433.

tion entered into upon the insolvency of the corporation, under which provision is made for the participation only of creditors holding existing liabilities of the corporation. Thus, the Eastern Railroad Company of Massachusetts, having become greatly embarrassed and practically insolvent, a statute was enacted for its relief, and the securing of its debts and liabilities.[11] This act authorized the corporation, by a mortgage of all its property to trustees, to secure an extension of its debts, for a period of thirty years at a reduced rate of interest. The existence of the corporation was preserved, but the stockholders had only the ultimate chance of redeeming the property. A leading purpose of the act was to give to all its actual creditors, without regard to the nature of their claims, an equal participation in the mortgage security. The owners of certain bonds of another railroad company, indorsed and guaranteed by the Eastern Railroad Company, claimed the right to participate in the benefits of this mortgage. The guaranteed bonds had not fallen due, and there had been no default in the payment of the interest upon them. The holders of the guaranteed bonds did not, therefore, claim immediate participation, but asked to have certificates of indebtedness set aside to an amount sufficient to secure the guaranty of the bonds, and in default of the payment of the interest or principal of the bonds, they claimed the right to receive the interest on such certificates, and to share in the security. But the court denied the claim upon the ground that no provision was made for contingent claims.[12]

§ 274a. **The right of bondholders to pursue a living guarantor or the estate of a deceased one upon a contract of guaranty** or the right against property mortgaged by guarantors cannot be regarded as assets, legal or equitable, of a corporation which must be exhausted before resort can be had to a stockholder's double liability under a statute. The liability which a guarantor incurs is not an asset of the principal. Stockholders cannot insist as a matter of right that the creditors of the corporation shall enforce the contract, even if all the necessary parties to such enforcement are brought into the proceedings. Such a guaranty is, however, an indemnity contract in favor

[11] Acts 1876, ch. 236.

[12] Merchants' Nat. Bank v. Eastern R. Co. 124 Mass. 518.

of stockholders which they may enforce in their own behalf if they take proper steps to do so.[13]

§ 275. Trust to apply earnings to payment of guaranteed bonds. —In the leading case of the Eastern Railroad Company v. Rogers, before the Supreme Court of Massachusetts,[14] the holders of the bonds of a leased road guaranteed by that company sought to add to the value and obligation of a common guaranty a trust to retain and hold the earnings of the leased road for the payment of the interest on the guaranteed bonds. The Eastern Railroad Company in New Hampshire leased its road for a long term of years to the Eastern Railway Company of Massachusetts. Subsequently the Portsmouth, Great Falls, and Conway Railroad Company became a party to the agreement. The scheme of the three companies, as stated by Judge Morton in delivering the opinion of the court, seems to have been to form a single or consolidated line of railroads, so far as they could without violating the laws of the states in which they were respectively incorporated. The Portsmouth, Great Falls, and Conway Railroad Company was to complete its road and appurtenances out of its capital stock or otherwise, at its own cost and expense. After it was completed the Eastern Railroad Company was to manage the three roads, and to pay out of the net earnings of the consolidated line dividends to the stockholders of the several roads *pari passu*, and these dividends were to be in lieu of and in full for the rent of the leased roads.

After the agreements were made, it was found that the Portsmouth, Great Falls and Conway Railroad Company was not able to perform its contract, and to construct and complete its railroad from its capital stock or other resources. To enable it to do so, it borrowed of the Eastern Railroad Company a large sum of money. A part of the sum so borrowed was repaid by issues of stock. The balance, amounting to one million dollars, was repaid by issuing to the Eastern Railroad Company bonds of the Portsmouth, Great Falls and Conway Railroad Company, payable in 1892, with interest at the rate of seven per cent., payable semi-annually. The Eastern Railroad Com-

[13] Winthrop Nat. Bank v. Minneapolis &c. Co. 77 Minn. 329; 79 N. W. 1010.

[14] 124 Mass. 527, 533.

pany negotiated and sold a part of these bonds, and pledged others of them, guaranteeing their payment. The holders of the bonds now claim that they were entitled to have the interest on them as it should accrue paid out of the earnings of the road in priority of the other creditors. They based their claim upon a provision of the lease that out of the gross amount of the tolls and income of the railroads there should be deducted and paid all charges and expenses of the lessee company in maintaining and operating the roads, taxes, rents, repairs, wages, and damages being enumerated with other things, "and generally all charges that may be incurred in the management of the business or concerns of the said railroads, or any part thereof, and all incidental charges and expenses, and the interest that may accrue on any past or future loans."

Upon the subsequent insolvency of the Eastern Railroad Company and the adoption of the legislation before referred to for its relief, the holders of the guaranteed bonds claimed that either the Eastern Railroad Company took the earnings of the Portsmouth, Great Falls and Conway Railroad charged with a trust to pay the interest on their bonds, or that the interest on these bonds is to be regarded as in the nature of rentals or operating expenses.[15] The

[15] Morton, J., delivering the opinion, said: "We cannot concur in this view of the purpose or effect of the article. As we have before said, it was contemplated as a part of the arrangement between the parties that the Eastern Railroad Company should, as rent or in lieu of rent of the leased roads, pay to their stockholders, pari passu, with its own stockholders, dividends out of the net earnings of the three roads. It was natural and almost necessary, in order to avoid future misunderstanding and litigation, that the contracts should contain provisions as to the mode of determining what should be deemed to be net earnings. We think this was the purpose of the fourth article, and that it was intended for the direction and protection of the Eastern Railroad Company, and not to enlarge its liabilities. It contains no words of covenant or promise on the part of the Eastern Railroad Company. It provides merely that 'from and out of the gross amount of the tolls and income of the railroads owned by the said parties hereto respectively shall be deducted and paid from time to time' the charges, expenses, and payments enumerated, including 'the interest that may accrue on any past or future loans.' By this was meant the interest which the Eastern Railroad Company might pay upon its loans. To hold that it was intended as a covenant, that it would pay the interest on any money which the lessor might

court held that the holders of the guaranteed bonds of the Portsmouth, Great Falls and Conway Railroad Company had no claim upon the earnings of the Eastern Railroad Company; that the former company was primarily liable to pay the bonds and the interest as it should accrue; that the only liability of the Eastern Railroad Company was a contingent and a collateral liability, arising from its contract of guaranty. It followed that it was not the duty nor the right of the Eastern Railroad Company to apply the earnings of its railroad to the payment of the interest on the bonds of the Portsmouth, Great Falls and Conway Railroad Company, as it might from time to time accrue and become due.

§ 276. Indorsement of a bond.—A railroad company which has transferred, by indorsement, a negotiable bond issued by a municipal corporation, is bound as an indorser of negotiable paper, if its liability be fixed by a proper demand and notice. It has been suggested that such a liability is not fairly in the contemplation of the parties to an indorsement of a bond which may have twenty or even forty years to run; but whatever force this view might have in case of an indorsement of such an instrument by an individual, it has none in case of a corporation, which does not die.[16]

§ 277. A state is bound by its indorsement of the bonds of a corporation duly authorized by statute, in the same way that an individual or private corporation is bound by a like contract; and its liability is governed by the same rules and principles of law.[17]

If the instrument of indorsement by a state sets out the official

borrow, would be inconsistent with the previous stipulations of the contract, by which the lessor agreed to complete the road at its own cost and expense, and by which the only rent to be paid by the lessee was in the form of dividends. No language is used in this article which purports to create any new liability of the Eastern Railroad Company. It enumerates various charges and expenses which the company may incur in the management of the roads, but its liability to pay those charges and expenses is not created by this article, but out of other independent contracts or duties."

[16] Bonner v. New Orleans, 2 Woods (U. S.), 135.

[17] State v. Cobb, 64 Ala. 127; Gilman v. New Orleans &c. R. Co. 72 Ala. 566; Morton v. New Orleans &c. R. Co. 79 Ala. 590.

character of the officer executing the indorsement, it is immaterial whether he adds his official title after his signature or not.[18]

§ 278. The indorser of state bonds is bound by his indorsement, though the bonds be void because issued under unconstitutional legislation. Under certain legislation of the State of Florida to aid railroads by an exchange of bonds, the liability of the railroad companies was construed to be that of guarantors or indorsers of the state bonds, and they were held to be so liable, although the legislation was pronounced unconstitutional, and the bonds void as as to the state. The railroad companies having put them upon the market as valid bonds, these companies are estopped from setting up their unconstitutionality.[19] "As against the companies," said Chief Justice Waite, "they occupy in the market the position of commercial securities, and may be dealt with and enforced as such. The companies, through their faithless agents, are in a position where they must meet those they have dealt with commercially, and respond accordingly. In commerce, commercial paper means what on its face it represents, regardless of what its maker or promoter may have got for it. The bonds of the state in the open market purported to be what they called for. The companies put them out, and in legal effect, as we think, indorsed them. A *bona fide* holder can now require the indorser to respond to his indorsement commercially: that is to say, by paying what he in effect agreed the maker must pay."

However, the indorsement of state bonds by a railway company in return for their issue in aid of the company does not create a lien for their security upon its property or revenues. The existence of this liability does not prevent the company from giving a mortgage on its property for any bonds it may issue.[20]

§ 279. A bona fide holder may presume that an indorsement is regular. The indorsement by the state of Alabama of the bonds of the Montgomery and Eufaula Railroad Company was claimed to

[18] Levy v. Burgess, 6 J. & S. (N. Y.) 431.

[19] Railroad Companies v. Schutte, 103 U. S. 118, 144.

[20] McKittrick v. Arkansas Central R. Co. 152 U. S. 473, 496; 14. Sup. Ct. 661.

be void, because the statute authorized the indorsement of first bonds only, while, as it was alleged, there was a prior mortgage upon the company's property, and the bonds could not, therefore, be first mortgage bonds. "Let us concede," said Judge Woods, of the Circuit Court of the United States,[21] "what defendants claim, that there was a prior mortgage on the road at the date of these bonds. Were the holders of the bonds under the necessity of taking notice of that fact and does the fact make the bonds void in the hands of a *bona fide* holder for value? . . . The legal authority to make the indorsement is sufficiently comprehensive to include the indorsement of the bonds in question; and the governor having placed his indorsement upon the bonds, and certified in the indorsement itself that it was made in pursuance of the act of the legislature, I think a *bona fide* holder has the right to presume that all precedent requirements have been complied with, and that there are no prior liens upon the railroad; and, so far as he is concerned, this presumption cannot be rebutted."[22]

II. *Corporations cannot enter into these Contracts without Legislative Authority.*

§ 280. It is no part of the ordinary business of a railroad company or other corporation to undertake the payment of the debts of others;[23] and therefore, without legislative authority in this be-

[21] Young v. Montgomery &c. R. Co. 2 Woods (U. S.), 606.

[22] Knox County v. Aspinwall, 21 How. (U. S.) 539; Mercer Co. v. Hacket, 1 Wall. (U. S.) 83; Meyer v. Muscatine, 1 Wall. (U. S.) 384.

[23] Bank of Genesee v. Patchin Bank, 13 N. Y. 309; Smead v. Indianapolis &c. R. Co. 11 Ind. 104; Stark Bank v. United States Pottery Co. 34 Vt. 144; Central Trust Co. v. Indiana &c. R. Co. 98 Fed. 666; Madison Plank Road Co. v. Watertown P. Co. 7 Wis. 59; Central Bank v. Empire &c. Co. 26 Barb. (N. Y.) 23; Bridgeport City Bank v. Empire &c. Co. 30 Barb. (N. Y.) 421; Farmers' &c. Bank v. Empire &c. Co. 5 Bosw. (N. Y.) 275; Best Brewing Co. v. Klassen, 185 Ill. 37; 57 N. E. 20; 76 Am. St. 26, reversing 85 Ill. App. 464. Consequently a pledge of corporate property to secure the individual debt of a director is ultra vires and void. Wheeler v. Home Sav. Bank, 188 Ill. 34; 58 N. E. 598, reversing 85 Ill. App. 28; Hodson v. Eugene Glass Co. 156 Ill. 397; 40 N. E. 971; 54 Ill. App. 248; Singer

half, a corporation has no power to enter into the engagement of a guaranty or indorsement of the bonds or other negotiable instruments of another corporation, or of a person; or to enter into the more indirect engagement of guaranteeing the dividends of another company;[24] or of purchasing the stock of another company;[25] or of completing the line of a railroad company under an agreement to work the line;[26] or of aiding in the extension or improvement of another railroad company.[27]

Legislative authority to railroad and other corporations to enter into the contract of guaranty is most frequently given by special statute, although there are some general statutes for this purpose.[28]

Neither can corporations, according to the rule adopted in this country, purchase, hold, or deal in the stock of other corporations, unless expressly authorized to do so.[29]

Piano Co. v. Walker, 113 Iowa, 664; 83 N. W. 725. An unauthorized guaranty is void even in the hands of a bona fide holder. Louisville &c. R. Co. v. Ohio Valley &c. Co. 69 Fed. 431.

[24] Coleman v. Eastern Counties R. Co. 10 Beav. 1. See Logan v. Courtown, 13 Beav. 22; Rhorer v. Middlesboro &c. Co. 103 Ky. 146; 44 S. W. 448; Marble Co. v. Harvey, 92 Tenn. 115; 20 S. W. 427; 18 L. R. A. 252n; 36 Am. St. 71; Marbury v. Kentucky &c. Co. 62 Fed.

[25] Mutual Savings Bank &c. v. Meriden Agency Co. 24 Conn. 159; Salomons v. Laing, 12 Beav. 339.

[26] Great Western R. Co. v. Preston & Berlin R. Co. 17 U. C. Q. B. 477.

[27] East Anglin R. Co. v. Eastern Counties R. Co. 11 C. B. 775; MacGregor v. Deal & Dover R. Co. 18 Q. B. 618.

[28] As in West Virginia, where any railroad or other private corporation or joint stock company may, with the assent of the holders of two-thirds of its stock, had by a vote at a stockholders' meeting, subscribe for or purchase the stock, bonds, or securities of any railroad company, whether incorporated by special charter or under the general railroad act; and may with like assent become surety for, or guarantee the debts of, such railroad company, or in any other manner aid such railroad company in the construction of its railroad or other works or improvements. Acts 1877, ch. 88; Acts 1872–73, ch. 88, § 40. In Massachusetts guaranties by railroad companies in certain cases are provided for.

[29] Zabriskie v. Cleveland &c. R. Co. 23 How. (U. S.) 381; White v. Syracuse &c. R. Co. 14 Barb. (N. Y.) 559; Connecticut &c. Ins. Co. v. Cleveland &c. R. Co. 41 Barb. (N. Y.) 9; Baltimore v. Baltimore &c. R. Co. 22 Md. 50; Mutual Savings Bank &c. Asso. v. Meriden Agency Co. 24 Conn. 159; Hodges v. New

Neither can a railroad company, without special authority, guarantee a certain amount of dividends on its own stock, although such contract may be made with a county as an inducement for the county to take stock in the company and pay for it with county bonds.[30]

A banking and trust company, having power to own, transfer, and guaranty notes and mortgages, is liable on a guaranty executed by its president without original authority after the corporation receives the benefit of the contract.[31] The guaranty of a lumber company to one erecting a building against liens for materials is germane to its business and within the powers of the corporation.[32]

§ 281. But to enable a railroad corporation to enter into a contract of guaranty it is not necessary that the authority to do so should be expressly conferred by statute. Under the railroad act of California, which provided that such a corporation "shall be capable in law to make all contracts . . . necessary for the construction, completion and maintenance of such railroad, . . . and generally shall possess all the powers and privileges, for the purpose of carrying on the business of the corporation, that private individuals and natural persons enjoy,"[33] it was held that a railroad company might make a valid guaranty of the bonds of another corporation. The guaranty in this case was entered into as a part of a leasehold agreement whereby the California Pacific Railroad Company leased its road to the Central Pacific Railroad Company for a long term of years, and the latter company stipulated to guarantee the payment of $2,000,000 of the bonds of the lessor company, payable in thirty years. The court held that this stipulation was not *ultra vires*. The reasoning of the court was, that a natural person might make such a contract, and therefore the exercise of this power by the corporation must be upheld, unless by its very nature it is a power which a corporation cannot exercise; but that there is no

Eng. Screw Co. 1 R. I. 312, 322; 53 Am. Dec. 624n; Central R. Co. v. Collins, 40 Ga. 582.

[30] Pittsburgh &c. R. Co. v. Allegheny County, 79 Pa. St. 210.

[31] Hunt v. Northwestern Mort. Trust Co. 16 S. Dak. 241; 92 N. W. 23.

[32] Interior Woodwork Co. v. Prasser, 108 Wis. 557; 84 N. W. 833. To similar effect see Winterfield v. Cream City Brewing Co. 96 Wis. 239; 71 N. W. 101, guaranty of rent of saloon by brewery.

[33] Stats. 1861, p. 608; and see, to like effect, Civil Code, § 354.

sufficient reason, deducible from the character of a railroad company and its business, why it may not guarantee the payment of a debt which it might directly contract to pay.[34]

[34] Low v. California Pacific R. Co. 52 Cal. 53, 61; 28 Am. R. 629; 9 Am. Railw. R. 366; 4 Cent. L. J. 487. McKinstry, J., dissenting, said in reference to the clause of the statute relied upon as impliedly giving authority to make the guaranty: "This clause gives no additional primary powers to the corporation. It follows after the enumeration of certain powers specifically conferred, and is but declaratory of the rule that powers incidental to the expressed powers conferred may be employed by a corporation. It is a legislative enunciation of the rule always recognized by the courts, that the implied or incidental powers which may be exercised by a corporation shall be ascertained by reference to the case of an individual upon whom should be conferred limited powers like those expressly granted to the corporation by its charter. If the clause quoted means more than this, what does it mean less than a grant to the corporation of every power which may be employed by an individual carrying on a private business for his personal emolument?"

This decision does not seem to be supported by sound legal principles and reasoning. It has been vigorously criticised. A writer in the American Law Register, vol. 25, pp. 513, 518, with reference to the general power of a railroad corporation to make such a guaranty, says: "In the case of a lease by one railroad corporation to another railroad corporation, the lessee pays its own debt when it pays the rent, which it owes as rent, and which it has agreed to pay as rent; in the case of a guaranty by the lessee of the bonds of the lessor, should the guarantor be compelled to pay the bonds, principal or interest, or any part thereof, in pursuance of its contract of guaranty, it pays an indebtedness of the lessor company, and consequently, may compel a reimbursement thereof. In the former case it pays as principal; in the latter, as surety. The former contract, however unwise it might be, the railroad company has the power (by statute) to make; and, consequently, may agree to pay the rent on the lease, the amount of the rent being simply a question of degree; the latter species of contract, it seems to us, it has not the power to make, there being no express statutory power to that effect, as it is in reality the loaning of the credit of the guarantor,—the guaranty of the debt of another. The contract of guaranty, ex vi termini, implies a loan of the credit of the guarantor." Neither is there any power to guarantee implied in the power to lease, nor is it appurtenant to the power to lease. The power to lease and the power to guarantee are as diverse as powers can well be. The statute confers on railroad corporations the powers of natural persons no further than

§ 282. The right to enter into the contract may be implied from authority to aid another company. A railroad company may guaranty the bonds of another railroad company under the authority of a general statute which authorizes railroad companies to aid other railroad companies by means of subscription to their capital stock or otherwise. If any acceptance of the statute by either of the corporations is necessary, this may be inferred in favor of persons holding guaranteed bonds, from the fact that the companies have done the act authorized by these statutes.[35]

§ 283. A corporation may, as a matter of course, indorse negotiable instruments which it has taken in the course of business or in the payment of debts due it, without special authority to do so.[36] This would be true of corporations which have no power to make instruments such as it receives and indorses.[37] A corporation having the power to create negotiable paper has the same power to indorse it, whether such power be implied or conferred.[38] It is within the corporate powers of a railroad company to guarantee bonds taken and held by it in the usual course of its business.[39]

But even if the guaranty be made for a purpose not authorized by the charter, as for instance for the accommodation of another road, a *bona fide* holder for value without notice is not affected by that fact.[40]

is necessary "for the purpose of carrying on the business of the corporation." The business of a leased railroad may be carried on without the lessee's guaranteeing the bonds of the lessor, and therefor such guaranty is not necessary for the purpose contemplated by statute. If a railroad corporation is to possess all the powers of a natural person in the broadest acceptation of the term, wherein would be the use of legislation seeking to prescribe its powers.

See Atchison &c. R. Co. v. Fletcher, 35 Kans. 236; 10 Pac. 596.

[35] Zabriskie v. Cleveland &c. R. Co. 23 How. (U. S.) 381. See Mathesis v. Brooklyn Heights R. Co. 96 Fed. 792.

[36] Olcott v. Tioga R. Co. 27 N. Y. 546, 549, 561; 84 Am. Dec. 298.

[37] Smith v. Johnson, 3 H. & N. 222.

[38] See Prescott v. Flinn, 9 Bing. 19, per Tindal, C. J.; Frye v. Tucker, 24 Ill. 180; Buckley v. Briggs, 30 Mo. 452; Hardy v. Merriweather, 14 Ind. 203.

[39] Madison &c. R. Co. v. Norwich Sav. Soc. 24 Ind. 457.

[40] Madison &c. R. Co. v. Norwich Sav. Soc. 24 Ind. 457. The court

§ 284. A railroad company having power to issue its own bonds may guarantee the bonds of municipal corporations issued in payment of subscriptions to the stock of the company. The obvious purpose and advantage of such a guaranty are to augment the credit of the bonds in the market, and to facilitate their sale, and the raising of money for the construction of its road.[41] It is, moreover, one of the recognized powers of a private corporation that it may borrow money, or become a party to negotiable paper in the transaction of its legitimate business, unless expressly prohibited; and until the contrary is shown, the legal presumption is, that its acts in that behalf were done in the regular course of its authorized business. In such case the corporation guarantees its own obligations, and not merely the debt of another.

§ 285. A railroad company may be bound by consenting to a representation of guaranty contained in the bonds of another company, as for instance that the former company had, in consideration of a lease to it of the road of such other company, guaranteed the payment of the interest on its bonds. The Pacific Railroad Company of Missouri was upon this ground held liable in an action brought directly against it by a holder of coupons due upon bonds issued by the St. Louis, Lawrence, and Denver Railroad Company.[42] The only promise made by the defendant company was one contained in a lease to it of the other railroad company, for an annual rental. The Pacific Railroad Company was interested in the construction and completion of the St. Louis, Lawrence, and Denver Road, and executed the lease in order to enable that company to negotiate its bonds and raise money to build the road, and the rental was appropriated specifically to the payment of the interest on such bonds. The bonds contained a statement that the payment of the interest

refer to Smead v. Indianapolis &c. R. Co. 11 Ind. 104, where it was attempted to draw a distinction between paper executed beyond the power and that executed within the power of the corporation, but by an abuse of the power in that particular instance, and declared that, as applied to commercial paper legal on its face, it is difficult to sustain such a distinction on any sound principle of law or reason.

[41] Railroad Co. v. Howard, 7 Wall. (U. S.) 392.

[42] Opdyke v. Pacific R. Co. 3 Dill. (U. S.) 55, 73.

was guaranteed by the Pacific Railroad of Missouri. In form, the St. Louis, Lawrence, and Denver Company furnished the consideration for the promise of the defendant company, rather than the bondholders. In reality, however, the bondholders furnished the means to build the road, the use of which, under the lease, constituted the consideration of the defendant's promise. The plaintiff, however, did not bring his suit upon the promise contained in the lease, but upon the implied promise contained in the representation in the bonds which the defendant company had caused to be issued in this form, or had consented to. "If this allegation can be proved," said Judge Dillon, "our opinion is that the defendant is bound to make good the guaranty, and that this guaranty attaches to and follows the bonds, and is available to every holder of them who relied upon it. In this view the promise by the defendant is a direct one to whoever becomes the holder of bonds on the faith of it, and, although the facts are different, the case falls within the principle of morality, fair dealing, and enlightened justice asserted by the Supreme Court of the United States.[43] If the foregoing is a correct view of the legal relations and rights of the parties, it follows that the contract between the defendant and the plaintiff was complete when the plaintiff bought the bonds upon the strength of the promise or representation which the defendant authorized, as it is alleged, to be made, and that the plaintiff's rights are in no wise dependent upon whether the Lawrence Company kept its contract in respect to taxes, fences, etc., and could not be affected by a subsequent recission of the contract, and surrender of the road by the defendant to the Lawrence Company."

§ 286. **Corporation estopped to claim that its indorsement is ultra vires.**—Although the indorsement or guaranty by one railroad company of the bonds of another company be *ultra vires* as in violation of the rights of the stockholders, both the corporation as an entity and the stockholders as such may be estopped from repudiating it, either by express ratification or by such acquiescence and

[43] In the cases of Lawrason v. Mason, 3 Cranch (U. S.), 492; 2 Am. Lead. Cases, 298; Woodruff v. Trapnall, 10 How. (U. S.) 190, 206; Curran v. Arkansas, 15 How. (U. S.) 304; Furman v. Nichol, 8 Wall. (U. S.) 44, 50.

enjoyment of the benefits of the contract as would make it a fraud to permit it to be set aside.[44] If the holders of the indorsed bonds can enforce them against the railroad company, individual stockholders cannot restrain the company from voluntarily discharging its liability. To show assent and acquiesence it is not necessary to prove the acquiescence of each individual stockholder. It is enough to show circumstances from which it may be reasonably inferred that the contract to be ratified was within the knowledge of all who chose to inquire, and the stockholders had full opportunity and means of inquiry.

A railroad company which has guaranteed the payment of the interest coupons of another road, and afterwards, upon coming into possession of the bonds, has sold and transferred a portion of them for value, is estopped to claim that the guaranty was *ultra vires*. The guaranty was additional security for the same debt evidenced by the bonds, and the guaranty passed with the bonds to the purchaser without special mention. Even if the guaranty was inoperative when it was made, because supported by no valid consideration, or made for no authorized purpose, it became operative when issued by the guarantor. The guaranty may then be treated as written at the time of the transfer, and as resting upon the consideration then passing.[45]

When a railroad company has the general power to make a guaranty, it is immaterial to a purchaser of the guaranteed securities whether its action in this respect be ratified by a vote of the stockholders, although such ratification is provided for by statute, if the provisions in this respect are intended for the protection of the shareholders, and relate chiefly to the mode or manner of the execution of the power. Holders of such coupons have the right to presume that the guarantors have done their duty, and have proceeded regularly in the execution of the power.[46]

[44] Cozart v. Georgia &c. Co. 54 Ga. 379; Atchison &c. R. Co. v. Fletcher, 35 Kans. 236; 10 Pac. 596; Stainback v. Junk Bros. &c. Co. 98 Tenn. 306; 30 S. W. 530, citing text.

[45] Arnot v. Erie R. Co. 67 N. Y. 315; aff. 5 Hun (N. Y.), 608.

[46] Connecticut &c. Ins. Co. v. Cleveland &c. R. Co. 41 Barb. (N. Y.) 9.

CHAPTER X.

THE DUTIES AND RIGHTS OF MORTGAGE TRUSTEES.

I. Nature of the trust assumed by mortgage trustees, §§ 287–298.
II. Effect of notice to mortgage trustees, §§ 299, 300.
III. Rights of mortgage trustees in possession, §§ 301–307.
IV. Removal of trustees and filling of vacancies, §§ 308–315.
V. Statutory provisions regulating the duties of mortgage trustees, and the choosing of new trustees, § 316.

I. *Nature of the Trust assumed by Mortgage Trustees.*

§ 287. **The nature and character of the trust assumed by one to whom a railroad mortgage is made for the benefit of bondholders** depend not merely upon the express terms of the mortgage deed, but upon the implications which arise from the relations of the parties and the condition of the trust property. As these circumstances change from time to time, the obligations of the trustee change also. Immediately upon the execution of the deed, and so long as no active duty is demanded of the trustee, the trust is little more than nominal; it is what is termed a dry, naked trust. Generally the trustees have nothing to do with the negotiation of the bonds, and so long as the interest is promptly paid so that no forfeiture occurs, their office is silent. But when a forfeiture has occured through the non-payment of the interest or principal secured, or through the breach of any other condition of the mortgage, new and important duties arise. The mortgage in terms generally requires the trustee to take possession of the mortgaged property and to sell it for the benefit of the bondholders. The fulfilment of these

express trusts in behalf of the bondholders is the primary and most obvious duty of the trustee. But in the performance of these trusts, other trusts arise by implication in favor of others besides the bondholders, and particularly in favor of subsequent incumbrances and the mortgagor. The duties of the trustees then become not only active, but responsible and delicate. They are then called upon to elect between delay and action; between, on the one hand, taking possession of the road and its fixtures, and thereby assuming at once the vast public and private burdens and responsibilities of a great public work; and on the other delay, and consequent complication and loss; or they must undertake the ulterior and final remedy of foreclosure.[1]

§ 287a. Rights and liabilities of the trustees in dealing with the bond issue.—Where the terms of the trust mortgage require the mortgagor to deposit a certain amount of cash with the trustee to secure a prior lien on the mortgaged property, but the mortgagor fails to make the deposit, the trustee is justified in retaining sufficient bonds to cover the required deposit. If the trustee does otherwise it is a fraud upon the purchasers of the other bonds for which the trustee would be liable. Consequently if the mortgagor sells the bonds retained by the trustee, the purchaser cannot compel a delivery of them and cannot maintain an action to foreclose the mortgage, such purchaser making no claim to a *bona fide* holder for value.[2]

Mere expressions of opinion by the trustee for bondholders in respect to the value of the security do not render the trustee liable in

[1] Sturgess v. Knapp, 31 Vt. 1, 55, per Redfield, C. J.; Commonwealth v. Susquehanna &c. R. Co. 122 Pa. St. 306; 15 Atl. 448; 1 L. R. A. 225.

Where the trustee is to certify bonds and superintend their sale and the application of proceeds and to perform other duties involving discretion, an active trust is created which constitutes the transaction of business by a foreign corporation within the jurisdiction. Farmers' &c. Co. v. Lake Street R. Co. 173 Ill. 439; 51 N. E. 55; 68 Ill. App. 666.

[2] Moses v. Philadelphia &c. Co. 127 Ala. 433; 29 So. 463; 32 So. 612. In a subsequent appeal of the same case it was held that the purchaser was entitled to the surplus after the prior lien and the balance of the bond issue had been paid off. Moses v. Philadelphia &c. Co. 131 Ala. 554; 32 So. 612.

an action of deceit, as the value is a mere matter of opinion upon a subject about which absolute knowledge cannot be expected. But a false statement by the trustee in regard to the title being free from incumbrances renders him liable for deceit to such bondholders as bought in reliance on his statement.[3]

The limited and guarded terms of a trustee's certificate cannot be lawfully held to embrace a representation or guaranty of the truthfulness of the description of the obligation as made by the obligor. Trustees act for a comparatively trifling consideration, limiting their liability to their own acts of negligence and misconduct, and it would be unfair to put so serious a burden as a guaranty upon them. So far as appears, there is not a single adjudication extending their liability to even an implied guaranty of the securities whose mere identity they have authenticated.[4]

§ 288. **When it becomes the duty of a trustee to enforce the mortgage, the duty is a personal one,** which cannot be delegated to any other person or persons. If the trustee allows persons who claim to be owners of a majority of the mortgage bonds to institute proceedings and to sell the property, the trustee paying no attention to the proceedings, but leaving them wholly in the control and direction of such persons, the trustee is liable to a bondholder for any damages sustained by him by reason of his neglect faithfully to discharge the duties of his trust.[5]

§ 289. **It is the duty of a mortgage trustee to protect the security he has taken for the bondholders** to the utmost of his ability. It is hardly consistent that such trustee should at the same time occupy the position of construction agent of the company. It is at any rate fraudulent for such trustee to confederate with the company in disposing of a large amount of iron rails bought by the company for its use and embraced in the mortgage as after-acquired property. To warrant such a diversion of the property specifically

[3] Nash v. Minnesota Title &c. Co. 159 Mass. 437; 34 N. E. 625.

[4] Tschetinian v. City Trust Co. 97 App. Div. (N. Y.) 380; 80 N. Y. S. 1053.

[5] Merrill v. Farmers' &c. Co. 24 Hun (N. Y.), 297.

appropriated to the construction of the road, and the security of the bondholders who advanced money to build it, would at least require the proof of an urgent and clear necessity that could not be financially provided for in any other way.[6] The utmost good faith is required in transactions of this nature resulting in the sale of any portion of the mortgaged property. If the trustee be remiss in his duty to protect the security, the bondholders may themselves maintain an action to prevent a diversion of the property.

For the same reason a mortgage trustee in possession of a railroad cannot make a valid contract for the leasing of the road to another railroad corporation in which he is a stockholder and director.[7]

Moreover, it is the duty of the trustee to see that the property is not burdened with the unjust demands or unnecessary expenditures of others. It is not enough for him merely to be ready to contest such a demand when it is called to his attention by the bondholders.[8]

§ 289a. A mortgage trustee may be bound by provisions in the deed of trust in regard to the issue of the bonds. Thus a deed of trust provided that the net proceeds of the bonds should remain in the hands of the trustee to be paid out only for the purpose of acquiring property and constructing and equipping the railroad, and to be "paid out only on the written order or request of the executive committee" declaring the purpose for which such proceeds were to be used. The failure of the trustee to carry out such provisions was held to constitute a breach of an implied legal duty springing from the relation of trustee and *cestui que trust*, upon which an action against the trustee would lie by aggrieved bondholders. "It seems only reasonable," said the court, "that the bondholders should be protected by the positive covenants of the mortgagor and all of those obligations that may be fairly implied as resting upon the trustee. It is unfortunately the case that the duties of trustees under rail-

[6] Weetjen v. St. Paul &c. R. Co. 4 Hun (N. Y.), 529.

[7] Ashuelot R. Co. v. Elliot, 57 N. H. 397.

[8] De Betz's Petition, 9 Abb. (N. C.) 246. Consequently a trustee is under no duty to increase the mortgage debt for the purpose of completing a partly constructed road. Frishmuth v. Farmers' &c. Co. 95 Fed. 5.

road and other mortgages are too often performed in a perfunctory manner, unless there is default in the payment of interest, and the trustees are called upon to take possession of the property and foreclose the mortgage in pursuance of the express duties imposed upon them."[9]

§ 290. **It is the duty of trustees intrusted with the sale of lands for the benefit of the bondholders to make the sales as available as possible for the extinction of the debt** for the security of which they hold the land. A trust deed provided that the trustees should apply the proceeds arising from sales of lands granted for the aid of the road, first, to the payment of interest when the earnings of the road were insufficient; second, to the purchase of outstanding bonds when these could be had within a limited price. There being at one time insufficient income to pay the coupons as they matured, the company issued scrip payable on time, reserving the privilege of paying at any time, and the coupons were surrendered to the trustees as collateral security for the payment of the scrip. It was held to be the duty of the trustees at a subsequent time, when the earnings of the road were sufficient to pay the current coupons, when bonds could not be bought within the limit specified, and when investments could only be made at a lower rate of interest than the scrip bore, to apply funds in their hands to the payment of the coupons for which the scrip was given.[10]

§ 291. **The trustees have no power to assent for the bondholders that an unsecured debt may be paid in preference** to their secured bonds. The fact that a floating debt of a railroad company has been contracted for the payment of interest on its bonds, and for supplies and repairs for the benefit of the company's property, gives the court no power, without the consent of the bondholders, to direct the application of the income of the road to the payment of it, although the trustees of the bondholders in a suit to foreclose the mortgage apply for authority to make such payment, and it appears that such debt could be paid on favorable terms, and that the pay-

[9] Rhinelander v. Farmers' &c. Co. 172 N. Y. 519; 65 N. E. 499, affirming 58 App. Div. (N. Y.) 473.

[10] Little Rock &c. R. Co. v. Huntington, 120 U. S. 160; 7 Sup. Ct. 517.

ment of it would be equitable, and probably for the interest of the bondholders in the way of facilitating the reorganization of the company.[11] The court said that these were doubtless strong considerations when addressed to the bondholders themselves. "But can this court waive the rights of bondholders because we might think it would turn out to their advantage? Can we make a contract for them because we think it would be a good contract? Have we the power to take money which belongs to them and give it to others without their consent, because we think it would be for their interest? They have not consented to this diversion of their money, and no one who is authorized to do so has consented for them. For the trustees to undertake to give assent for the bondholders is clearly outside of their powers and duties, which are plainly prescribed in the deed of trust. This court is, in my judgment, without any power to make the decree recommended by the report of the master. To undertake to do it would be to invade the legal rights of the bondholders, and if established, as within the power of a court of equity, would shake the credit of railroad securities throughout the world."

A trustee for mortgage bondholders who in violation of the trust consents that receivers' certificates shall be given a preference lien over the mortgage bonds does not thereby bind the bondholders or estop them to object to the validity of such certificates.[12]

§ 292. **The trustees have no right, without the consent of the bondholders, to waive a default,** or to recognize a subsequent mortgage as having priority. The mortgage might authorize the trustees to waive a default, or it might provide that they should foreclose only upon the request of the holders of a certain proportion of the bonds secured. But such a power will not be extended beyond its strict terms. Where a mortgage required the trustees upon any default in the payment of principal or interest, on the requisition of the holders of not less than one-fourth of the bonds,

[11] Duncan v. Mobile &c. R. Co. 2 Woods, 542 546.

[12] Belknap Sav. Bank v. Lamar &c. Co. 28 Colo. 326; 64 Pac. 212. The court said: "We decline to dignify, with discussion, the argument that such action of a trustee binds its beneficiaries. We merely dismiss it with the observation that neither in morals nor in law will it bear scrutiny, and a court of equity will not listen for a moment to such an unconscionable proposition."

to take possession and sell, and by another article provided for furtheir assurances of title to the trustees, but gave the trustees a discretion to waive the rights of the bondholders by reason of such default, subject to the right of a majority in interest of the bondholders to require the trustees to enforce their rights, it was held that the discretion to waive the default was confined to a default in the covenant for further assurance, and that any general words, though very broad, used in connection with the provision in regard to such waiver, must be construed to relate to covenants to be kept by the mortgagee other than a default in the payment of principal or interest.[13] "It is easy to see that discretion to waive a default, sustained by a majority in interest of the bondholders, might prudently and safely be given to the trustees as to covenants for assurance, and to furnish an inventory and the like, while it is scarcely possible to suppose that the enormous discretion of waiving every default of interest or principal was intended to be conferred. Stockholders of the company buying a trifling excess over half of the bonds could, with the aid of the trustees, practically annul and cancel the whole debt, and take to themselves the entire net earnings of the company."[14]

Holders of bonds are not bound by a statement made to the mortgagor by the president of the trustee company that if new bonds are issued he will see that they are exchanged for the old ones, and that the latter will be taken up and cancelled, nor does such statement require the bondholders to disprove his authority.[15]

§ 293. **A mortgage trustee while in possession of a railroad under the mortgage is a trustee of the corporation,** as well as of the bondholders. It is inconsistent with the duties which such trustee owes to the corporation to deal in the bonds which the mortgage was given to secure for his own private gain. This doctrine of the trust obligations of a mortgage trustee while engaged in the active discharge of his trust is strongly brought out in the case of

[13] Hollister v. Stewart, 111 N. Y. 644, 655; 19 N. E. 782; Guilford v. Minneapolis &c. R. Co. 48 Minn. 560; 51 N. W. 658; 31 Am. St. 694, citing text.

[14] Per Finch, J., reversing 37 Hun (N. Y.), 645.

[15] Unity Co. v. Equitable Trust Co. 204 Ill. 595; 68 N. E. 654, affirming 107 Ill. App. 449.

the Ashuelot Railroad Company v. Elliot, before the Supreme Court of New Hampshire.[16] While the defendant was the treasurer and clerk of the corporation, a mortgage of its road was executed to him as trustee, to secure the bonds of the company. For ten years afterwards the corporation remained in possession of the mortgaged property, and the defendant continued to act as its clerk and treasurer. So long as the interest on the bonds was paid, there was no breach of condition, and nothing for him to do in the way of an active performance of any trust under the mortgage. Thus far, of course, it was a dry and naked trust. But the bonds not being paid at maturity, it thereupon became, by the terms of the mortgage, the right and duty of the trustee to enter and hold possession of the property for the purpose of realizing upon the security and enforcing payment of the debt. He did this, and soon after an act of the legislature was obtained, which, it was generally supposed, had the effect to foreclose the mortgage, and to invest the bondholders with the absolute ownership of the road and franchise, with the substantial attributes of a corporation. The conduct of the trustee in the management of the property was based upon this supposition for ten years and more, until the Supreme Court of the state held that the statute was ineffectual to foreclose the mortgage; but the legal result of this decision was that the defendant during all this time had been in possession, not as the agent of the absolute owners of the road, but as the trustee of the bondholders under and by virtue of the mortgage. During this period he had purchased from time to time, at their market price, bonds secured by this mortgage to the amount of $46,000; and the value of these bonds having finally about doubled, he was required to account to the corporation for the profits actually realized by such purchase. Mr. Justice Ladd, upon the point of his accountability for these profits, said: "It is true, as the defendant says, that the legal liability of the corporation upon the bonds has all the time been to pay their full amount, with interest, to the holders. It is at the same time true, that when the bonds are selling in the market or otherwise at fifty cents on a dollar, the debt might be extinguished by the corporation for one-half the amount they are legally liable to pay. The actual value of the bonds was all the time measured by the amount for which they could be

[16] 57 N. H. 397, 435.

sold, and this would depend upon the understood ability of the corporation eventually to pay them in full. Now, when Mr. Elliot, after he had taken possession of the road under the mortgage, became the owner of $46,000 of the bonds secured thereby, his individual interest lay strongly in the direction of enhancing their salable value, and so of increasing the amount for which the corporation might procure the extinguishment of the debt and remove the mortgage. The master finds that his buying up the bonds was in part the cause of advancing their price from about fifty per cent, to about par. His duty to the bondholders did not call for any such private speculation for such a purpose; and even though it should be said that a legal wrong was not thereby done the mortgagors, inasmuch as their undertaking was to pay the full face of the bonds, the proceeding, nevertheless, strikes my mind as quite inconsistent, in an equitable point of view, with the relation of confidence and trust in which he stood to them."

§ 294. The trustees represent the bondholders in suits affecting the mortgage security. The rule of chancery pleading, which allows some parties to sue or be sued in behalf of all, where their right is the same and their number is so large as to render it difficult to bring them all before the court, is especially applicable in all suits for the foreclosure of railroad mortgages. Such mortgages are almost invariably made to trustees; and ordinarily the trustees represent the bondholders in all matters of litigation respecting their common and general rights. Whether they are plaintiffs seeking a foreclosure, or as subsequent mortgages are made defendants, they represent the bondholders for whom the trusts are held, and a decree is ordinarily as binding on such bondholders as if they had been made parties. The bondholders are in such case *quasi* parties to the suit, and have the right at any time to intervene and become actual parties.[17] They may come in under the decree and take the benefit

[17] Campbell v. Railroad Co. 1 Woods (U. S.), 368; Chickering, In re, 56 Vt. 82; Atlantic &c. Co. v. Crystal Water Co. 72 App. Div. (N. Y.) 539; 76 N. Y. S. 647, citing text. Where suit is brought by contractors to establish a prior lien, individual bondholders need not be made parties defendant but it is sufficient to make the trustee a party. St. Louis &c. R. Co. v. Kerr, 153 Ill. 182; 38 N. E. 638.

of it, or, so long as the proceedings are not definitely closed, they may obtain a hearing, and show the proceedings to be erroneous. "Where complainants are allowed to dispense with parties on account of their numerousness, any one of whom would have a right to come in by petition and be made a party, if necessary, to protect their interests, they ought to proceed with the utmost fairness and good faith, and not resort to anything like sharp practice in procuring a final decree, which is to be binding on all. Any deviation from this requirement would be a proper ground to be considered on the question of opening or setting aside the decree at the instance of such an omitted party. The court would not tolerate any conduct of the complainants calculated to lull such parties into security, and induce them to remit any degree of watchfulness in regard to their interest which they would have otherwise exercised."[18]

The trustees of a railway mortgage have sufficient authority and interest to enable them to maintain a bill in equity to enjoin an alleged illegal proceeding which will seriously depreciate the value of the bonds secured, or to maintain a bill to contest a claim of priority made in behalf of another mortgage under which the road and its property are about to be sold; especially when the bondholders are numerous and widely scattered, the trustees, as representing them and holding the title to the road and property, have a right to apply for judicial intervention to have the question of priority settled before any sale is attempted.[19]

§ 294a. **Bondholders not a party to a suit by the trustee to foreclose a mortgage cannot bring a bill of review** to avoid a decree of sale in favor of the trustee, except in case the trustee himself would be entitled to maintain such a bill. To avoid what the trustee has done in their behalf, they must proceed in some other way than by a bill of review.[20] Ordinarily a judgment rendered in an action to foreclose a deed of trust brought by the trustee is conclusive on all the bondholders, especially where the trust deed provides that the trustee shall represent all the bondholders, and shall have the

[18] Per Mr. Justice Bradley, in Campbell v. Railroad Co. 1 Woods (U. S.), 368.

[19] Murdock v. Woodson, 2 Dill. (U. S.) 188.

[20] Shaw v. Railroad Co. 100 U. S. 605.

exclusive right to bring suit on the request of the majority, and that no bondholder shall be entitled to sue without first having requested the trustee to sue.[21]

Consequently, a court will not be compelled by mandamus to admit such a bondholder as a party for the purpose of allowing him to take an appeal, the granting of such a petition for intervention being a matter within the discretion of the court.[22]

But persons belonging to a class represented in a suit, such as bondholders, are regarded as *quasi* parties, and may be heard on petition or motion. A cross-bill can, however, be sustained only on matters growing out of the original bill, and cannot be used as a means of obtaining relief in respect to a separate cause of action.[23] Where bondholders intervene in this manner, alleging misconduct on the part of the trustee whereby the value of the security is diminished, the matters thus arising are so connected with the subject-matter as to entitle the bondholders to substituted service on the trustee's attorney, the trustee being a non-resident.[24]

§ 295. If in any case the trustees, to whom a corporation mortgage is made, fail or refuse to act, any of the bondholders, for themselves and in behalf of the rest, may step forward and put in motion the machinery of the law making the trustees parties defendant. Especially if in any case the bondholders can show that some fraud has been practiced or connived at by the trustees, that they have acquired interests adverse to the bondholders,[25] or that they have been made the victims of fraud, the bondholders may apply to the court for such relief as a party to the suit would be entitled to; or they may institute such other auxiliary, revisory, or supplemental proceedings as a party to the suit might institute; thus, they might bring a bill of review, or a bill for relief against a fraudulent decree, or conjoin both in one.

Whatever rights, as against the mortgagor, are vested in the trus-

[21] Manhattan Trust Co. v. Seattle Coal &c. Co. 19 Wash. 493; 53 Pac. 951.

[22] Fink v. Bay Shore &c. Co. 144 Fed. 837.

[23] Fidelity &c. Co. v. Mobile &c. R. Co. 53 Fed. 850.

[24] Gasquet v. Fidelity &c. Co. 57 Fed. 80.

[25] Webb v. Vermont Cent. R. Co. 9 Fed. 793.

tee in a mortgage given to secure the payment of bonds, inure to the benefit of the bondholder and are enforceable by him, in case of refusal or neglect on the part of his trustee to act for him upon request.[26] Where the trustee is a corporation and has dissolved and gone out of business, the bondholders may maintain a suit to foreclose, as equity will not permit a trust to fail for lack of a trustee.[27]

§ 295a. There can be no doubt of the right of bondholders to maintain an action to restrain a fraudulent diversion of a portion of property mortgaged for their security, when one of the mortgage trustees is in collusion with the company in effecting such diversion of the property; as where, for instance, the company, after purchasing a large amount of iron rails for the use of the road, which, as after-acquired property, were covered by the mortgage, authorized one of the trustees, who was also the construction agent of the company, to pledge, sell, or dispose of the iron, for the purpose of raising money to meet the construction account of the road. If the bondholders could not do this, their rights and interests would be wholly without protection; for the directors of the company authorized the disposition of the iron in violation of the plain terms of the mortgage, and under the circumstances of the case it might well be inferred that the other trustees acquiesced in the acts of the trustee who was the construction agent, and to whom the active management of the business was intrusted.[28]

§ 295b. Holders of bonds secured by a mortgage made to a trustee cannot ignore the trustee, and foreclose the mortgage by a suit in their own names, without showing that they have requested him to take advantage of a default of the mortgagor, and that he has refused or unreasonably neglected to do so. Until then the bondholders are under no necessity of proceeding in their own names

[26] Van Beuthuysen v. Central &c. R. 63 Hun (N. Y.), 627; 17 N. Y. S. 709; O'Beirne v. Allegheny &c. R. Co. 151 N. Y. 372; 45 N. E. 873; 80 Hun (N. Y.), 570; 30 N. Y. S. 588, affirmed in 158 N. Y. 466; 53 N. E. 211; Siebert v. Minneapolis &c. R. Co. 52 Minn. 148; 53 N. W. 1134; 20 R. L. A. 535n; 38 Am. St. 530.

[27] Louisville &c. R. Co. v. Eakins, 100 Ky. 745; 39 S. W. 416.

[28] Weetjen v. St. Paul &c. R. Co. 4 Hun (N. Y.) 529, 538.

and against the trustee.[29] As a general rule, where property is conveyed to a trustee as security for numerous bondholders, the trustee is the party to initiate or defend suits in respect to the security, and the bondholders have no standing unless he refuses or neglects to perform his duty. Where a trustee is entitled to indemnity, his refusal to proceed without indemnity does not justify bondholders in going ahead in their own names.[30]

The preference in favor of a trustee is because the trustee is presumed to represent all the bondholders and for convenience in practice: but if the trustee accepts a hostile position antagonistic to his duty as trustee, he then forfeits this preference as against a bondholder. Thus, for a trustee under a mortgage deed of trust to accept a deed of general assignment from the mortgagor, relieves a bondholder from the necessity of requesting the trustee to proceed with the foreclosure. There is an antagonistic and conflicting interest to be represented under these two deeds.[31]

Any emergency, such as absence from the jurisdiction, which makes a demand upon the trustee futile or impossible, and leaves the right of the bondholders without other reasonable means of redress, justifies their appearance as plaintiffs in a court of equity for the purpose of foreclosure. The bondholders are the real parties in interest; it is their right which is to be redressed, and their loss which is to be prevented.[32]

The method which a deed of trust provides for the removal of a trustee and the appointment of a new trustee must be pursued, unless good reasons are shown for proceeding otherwise, in disregard of such provisions.[33]

Where the position of trustee was vacant it was held that an owner of the majority of the bonds of a New Jersey corporation could, on the requisite default, maintain a suit in a federal court for Louisiana in his own name to foreclose the mortgage for all

[29] General Elec. Co. v. La Grande &c. Co. 79 Fed. 25.

[30] Falmouth Bank v. Cape Cod &c. Co. 166 Mass. 550; 44 N. E. 617.

[31] American &c. Co. v. Kentucky &c. Co. 51 Fed. 826.

[32] Ettlinger v. Persian &c. Co. 142 N. Y. 189; 36 N. E. 1055; 66 Hun (N. Y.), 94; 20 N. Y. S. 772.

[33] Dillaway v. Boston &c. Co. 174 Mass. 80; 54 N. E. 359.

bondholders, and the court would not compel him to go to New Jersey to have another trustee appointed.[34]

In a suit in equity for an accounting against trustees appointed to foreclose a mortgage and turn over the property to a new corporation, alleging that such a corporation was formed, but the trustees failed to turn over the proceeds and were guilty of negligence and misfeasance, the new corporation is not a necessary party. The new corporation has no standing as an independent entity in reference to this trust except as a creature of it, representing no one but the bondholders. A failure to turn over property to the new corporation is not a breach of contract with it; it is a breach of contract with the bondholders, and the bondholders may proceed directly against the trustees.[35]

§ 295c. **In California** it has been held that a bondholder is justified in proceeding on his own account, although the refusal of the trustee has been neither unlawful nor arbitrary, as where the trustee was not authorized by the trust deed to take action until requested to by a majority of the bondholders, and such a request has not been made.[36]

§ 296. **The trustee may exercise his discretion within the scope of his powers.**[37] If there are differences of opinion among the bondholders as to what their interests require, the trustee may properly

[34] Wheelwright v. St. Louis &c. Co. 56 Fed. 164.

[35] Dunning v. Bates, 186 Mass. 123; 71 N. E. 309.

[36] Citizens' Bank v. Los Angeles &c. Co. 131 Cal. 187; 63 Pac. 462; 82 Am. St. 341. In the opinion the court said:

"Where the deed authorizes the trustee to proceed upon the written request of a majority of the bondholders, it is held in those cases that he cannot act without such petition. But the bondholder has a right of action upon showing that the trustee has refused to bring the suit even though the trustee may have been justified under the provisions of the deed, in refusing. If this were not so, it would result in placing the same limitation on the right of the individual bondholder to bring the action as is placed on the trustee,—namely the written request of a majority of the bondholders,—and this would practically make it possible for a majority to deprive the minority of the remedy of foreclosure altogether." See also Chicago &c. R. Co. v. Fosdick, 106 U. S. 47; 1 Sup. Ct. 10.

[37] Shaw v. Railroad Co. 100 U. S. 605, 612.

be governed by the voice of the majority acting in good faith and without collusion. In proceedings to foreclose two mortgages on a railroad, the court ordered a sale, it appearing that the road was becoming more and more incumbered with receivers' certificates. The sale was objected to by a minority of the bonds secured by the second mortgage, on the ground that there were conflicting rights under the two mortgages which should be settled before sale. The trustees under both mortgages and the railroad company itself favored an immediate sale. The court, declaring that the trustees represented the bondholders in the foreclosure proceedings, and believing that the best interests of all parties would be promoted by a speedy sale, ordered all the property to be sold together, leaving the adjustment of conflicting rights to be made after the sale.[38]

The discretion lodged in most cases with the trustee may be taken away by the trust deed and transferred to the bondholders. Thus, under a provision that upon default for thirty days it shall be lawful for one-fifth or more of the bondholders to cause the principal to mature, the bondholders alone are to exercise this option, and the trustee need not join with them.[39]

§ 297. **A bondholder cannot maintain an action against a mortgage trustee for breach of trust in doing an act which has been sanctioned by the bondholder,** either by previous consent or subsequent ratification. Thus, in an action based upon allegations of breach of trust on the part of the trustee in transferring title to the mortgaged property, which he had acquired by purchase under a foreclosure sale, a bondholder, who had acquiesced in or ratified the acts of the trustee complained of, is not entitled to a judgment for a proportionate share of the money received by the trustee upon such transfer. Upon proof of such acquiescence the suit will be dismissed.[40]

§ 298. **Bondholders may maintain a bill to compel the mortgage trustees to take possession** of the mortgaged property, where

[38] First Nat. Bank v. Shedd, 121 U. S. 74; 7 Sup. Ct. 807; 30 Am. & Eng. R. Cas. 439; State v. Brown, 73 Md. 484; 21 Atl. 374.

[39] American &c. Co. v. Kentucky &c. Co. 51 Fed. 826.

[40] Butterfield v. Cowing, 112 N. Y. 486; 20 N. E. 369.

they neglect to do so after default, and allow the corporation to apply the income to the payment of unsecured debts; and it is no defence to such a bill that litigation may be necessary to ascertain what property is covered by the mortgage, or that a great burden and personal liability will be imposed upon the trustees for injuries done and debts subsequently incurred. Such burden and responsibility are incident to the trust they assumed in allowing the mortgage to be made to them.[41]

II. *Effect of Notice to Mortgage Trustees.*

§ 299. Notice to trustees under an ordinary mortgage deed of a railroad company is notice to the holders of the bonds secured by the mortgage. Such trustees are considered in the light of agents for the negotiating of the loan. They act for those who lend their money on the security of the mortgage. They are charged with the duty of protecting the interests of the bondholders, who are unconnected individuals, having no ready means of acting together except through the trustees, whom the law appoints to act for them.[42] Notice to the trustees is held to affect the title in their hands with reference to incumbrances upon the trust property. Actual notice to the trustees of a prior equitable mortgage is notice of it to the bondholders, who therefore take their bonds subject to the legal consequences of the incumbrance.[43]

[41] First Nat. &c. Co. v. Salisbury, 130 Mass. 303.

[42] Pierce v. Emery, 32 N. H. 484, 521, per Perley, C. J.; Western &c. Co. v. Coal Co. 8 W. Va. 406, 409; Fidelity Ins. Co. v. Shenandoah R. Co. 32 W. Va. 244; 9 S. E. 180.

[43] § 33; Miller v. Rutland &c. R. Co. 36 Vt. 452, 484. Per Barrett, J.: "The fact that the bonds are treated as negotiable, and pass from hand to hand like bank bills, does not affect the question of the agency of the trustees in reference to the security provided by the mortgage. Such bonds purport to be secured by a mortgage in trust to trustees who are designated and known. They are negotiated and purchased upon the security thus existing. That security consists in the property and title which exist in the trustees. By the purchase of the bonds, the purchaser voluntarily adopts the security as it exists in the trustees, and becomes cestui que trust under them, thereby adopting said trustees as his agents for holding the existing title, and administering the property

Bonds secured by mortgage were surrendered to the mortgage trustee before maturity, under an agreement that other bonds to be issued under a subsequent mortgage should be substituted for them. The trustee, without carrying out the agreement and substituting other mortgage bonds, executed a release of the mortgage, stating therein that the bonds "had been surrendered." The mortgage provided that, upon full payment of all the bonds at maturity, the trustee should enter satisfaction upon the record. The company was not in a condition to anticipate the payment of its bonds, and it did not in fact pay them. It was held that these facts and circumstances were sufficient to charge a subsequent mortgage trustee with notice of the terms and conditions upon which the bonds were surrendered; and therefore that the subsequent mortgagee took subject to the rights of the owners of the surrendered bonds to have them regarded as still outstanding and secured by the mortgage wrongfully released.[44]

§ 300. **Notice, however, to trustees who take a conveyance for the mere purpose of upholding an estate,** without having any previous connection with the title, is not always regarded as notice to the *cestuis que trustent*.[45] Yet in a case where the only trust expressed in a mortgage by a railroad company to trustees was to hold the property to secure the payment of the bonds named, it was held that an active, administrative trust was created, under which, even after a foreclosure, the trustees were authorized to make a lease of the road and property for a term of ten years, against the protest and remonstrance of a large majority in amount of the bondholders; and the objecting bondholders having obtained an injunction against the use of the road by the lessees, they were compelled to

held thereby to the intents specified in the creation of the trust. The question is not as to how cestuis que trustent would be affected by notice to trustees of transactions subsequent to the creation of the trust, or to their becoming cestuis under the trust, but as to how they are affected by notice to the trustees, which, as to them personally, affects the legal estate at the time, and in the act of their becoming trustees." Coe v. New Jersey R. Co. 31 N. J. Eq. 105; Fidelity Ins. Co. v. Shenandoah R. Co. 32 W. Va. 244; 9 S. E. 180.

[44] Fidelity Co. v. Shenandoah R. Co. 32 W. Va. 244; 9 S. E. 180.

[45] Pierce v. Emery, 32 N. H. 484, 521, per Perley, C. J.

pay heavy damages for the injury done to both the lessors and the lessees by the injunction.[46]

Notice to one mortgage trustee of irregularities in a county subscription does not operate to destroy the *bona fide* holding of bondholders under a deed of trust which includes, with the mortgaged property, county bonds issued under such subscription, but the trustees may enforce in behalf of the bondholders the payment of bonds given in payment of such subscriptions, and the bondholders are just as much entitled to the character of *bona fide* holders without notice as if no notice had ever come to any of the trustees.[47] They are not to be regarded as the agents of the purchasers of the bonds, but merely assignees, coupled with no interest, of the legal title of the property in trust for whoever may become purchasers of the bonds.[48]

III. *Rights of Mortgage Trustees in Possession.*

§ 301. Mortgage trustees on taking possession can use the franchise so far as necessary. Authority to a railroad company to issue bonds and "secure the payment of the same by mortgage, or deed of trust, on the whole or any part of the road, property, and income of the company, then existing or thereafter to be acquired." implies the authority to clothe the grantees with all needful powers to use the thing conveyed in a proper and beneficial manner. Under such a deed, transferring the whole property to trustees, and empowering them upon default to take possession of the road and to hold and manage it for the uses of the trust, the inquiry arose whether the trustees upon taking possession could exercise the franchises of the company in this manner. It was held that the trustees were not limited to using and operating the road as the agents of the company to which the franchise was granted, but might use and operate it in their own name and right, and enjoy the franchises granted to the corporation so far as necessary for the enjoyment of the property mortgaged to them.[49]

[46] Sturges v. Knapp, 31 Vt. 1, 54; 36 Vt. 439.

[47] Johnson County v. Thayer, 94 U. S. 631.

[48] Curtis v. Leavitt, 15 N. Y. 9, 194, 195.

[49] Palmer v. Forbes, 23 Ill. 301, 318. As to the intention of the

When mortgage trustees have taken possession of a railroad upon default under authority given by the mortgagee, they are entitled to retain possession until the whole debt is paid, unless the mortgage provides that they shall surrender possession upon receiving payment of the instalment then due.[50]

But trustees who have taken possession of a railroad upon a default in the payment of interest may be directed to surrender possession to the company upon the payment in full of all past due interest, and showing that it is in condition to meet future instalments of interest.[51]

§ 302. **In like manner when mortgage trustees obtain an absolute foreclosure by writ of entry and possession for three years, they hold this absolute title in trust** for the bondholders and for no other parties; and unless the bondholders organize a new company

legislature in authorizing the construction of the road, and afterwards the borrowing of money by mortgage to enable it to construct and equip the road, Chief Justice Caton said: "If it was the intention that that road should not be taken up and destroyed for the payment of the mortgage debt, but that it should be sold subject to the duty towards the public of continuing and operating it as a road, it follows necessarily, that it was the intention of the legislature that those into whose hands the road might fall, and upon whom this duty to the public of running and operating the road would devolve, should possess all the necessary rights and powers to enable them to perform this duty. . . . Perhaps it is not too much to say, that the extent of right conferred upon the company for the purpose of enabling it to finish, repair, and operate the road, was designed to be impliedly conferred upon the mortgagees in possession, or purchasers under the mortgage, to enable them to accomplish the same object; but it is not necessary now to say this, but we do say unhesitatingly, that the trustees or purchasers are endowed with sufficient powers, which are undoubtedly in the nature of a franchise, to enable them to discharge the duty which the public have a right to demand of them, by keeping in repair, maintaining, and operating the road, and to demand and receive a suitable reward therefor, and for this purpose they may use their own proper names, or adopt any other convenient business name, as any other individual or company may do, and they are under no necessity of adopting the name of the company to whose rights in the property they have succeeded."

[50] Wood v. Goodwin, 49 Me. 260.

[51] Union Trust Co. v. Missouri &c. R. Co. 26 Fed. 485.

the trustees execute their trust by disposing of the property, and distributing the proceeds among the bondholders pro rata. After the title has become absolute in this manner, the mortgagors and their privies in estate cannot be heard to object that the mortgage was not properly sealed, or that, on a true construction of its terms, an absolute judgment of foreclosure should not have been entered. The title of the trustees rests upon the judgment of foreclosure, and they may have a decree declaring their rights as against all parties claiming under the mortgagors by titles acquired subsequently to the mortgage.[52]

§ 303. **Mortgage trustees entitled to possession of the road under a decree are entitled to the earnings** from the commencement of the suit; for the effect of the decree is to establish their right of possession at the time the suit was begun, and to make the company's possession after that date wrongful. If the company has received the earnings, it is under obligation to account for them as a receiver of the property.[53]

§ 304. **The trustees may lease a road the title to which they have gained by strict foreclosure.** The Western Vermont Railroad Company executed a mortgage of its road and franchise to trustees, which contained no provisions in regard to the rights and duties of the trustees, either before or after foreclosure. In consequence of a default, the mortgage was foreclosed by a decree of strict foreclosure in the ordinary form, simply declaring that, if certain specified sums were not paid on or before certain specified times, the mortgagors should be foreclosed from all equity of redemption in the mortgaged property. Payment not being made in accordance with the decree, the title became absolute in the trustees. The bondholders were numerous, and widely scattered, and had no legal organization. No statute then existed in the state under which such bondholders, or the purchasers at a foreclosure sale, were authorized to organize themselves into a new corporation. The trustees had no

[52] Haven v. Grand Junction R. &c. Co. 12 Allen (Mass.), 337. And see Kennebec &c. R. Co. v. Portland &c. R. Co. 59 Me. 9, 47.

[53] Dow v. Memphis &c. R. Co. 124 U. S. 652; 8 Sup. Ct. 673, reversing 20 Fed. 768.

rolling stock for the road, and no means of purchasing any. For a short time the trustees operated the road through an agent, but at a material loss. Shortly after acquiring full title to the property the trustees leased the road to the Troy and Boston Railroad Company, a corporation created by the State of New York, owning a connecting road, for a period of ten years, for a satisfactory rent. The lease provided that if a majority in amount of the bondholders should, within ninety days from the date of the lease, unite in giving notice in writing to the lessees of their desire to terminate the lease at the expiration of one year, the lease should so terminate. The lessees went into immediate possession, and within ninety days from the date of the lease a committee, representing the holders of a majority of the bonds, instead of giving the notice provided for, gave notice that they denied the power of the trustees to make the lease, and that they regarded the lessees as trespassers in the use of the road. The lessees still retaining possession, certain bondholders, in behalf of themselves and all other bondholders who should come in to prosecute the suit, brought a bill praying for a decree that after the foreclosure the trustees had no right to make any disposition of the road except to convey it to the bondholders, and that the lease was null and void. But the court dismissed the bill, holding the lease to be valid.[54]

A strict foreclosure is now very rarely had; but it is conceived that the duties of trustees who purchase mortgaged property at a foreclosure sale for the benefit of the bondholders would be precisely the same as those of trustees who acquire the title by a decree of strict foreclosure. Provision, however, is now quite generally made by statute for the organization of purchasers at such a sale into a corporation, so that the management by trustees after foreclosure need be only temporary, and until such organization is completed.

§ 305. No right of set-off can accrue against the trustees under a mortgage after they have entered into possession of the mort-

[54] Sturges v. Knapp, 31 Vt. 1; and see 33 Vt. 486; 36 Vt. 439. Chief Justice Redfield delivered the opinion of the court, and fully examined the nature of the estate in the trustees created by the mortgage, the forfeiture, and the foreclosure. This was regarded as depending almost exclusively upon the implications growing out of the state of

gaged road. Thus the Wallkill Valley Railway Company having made default, the trustees entered into possession and received the rents and tolls for the benefit of the bondholders. They subsequently brought suit against an agent of the road for money collected by him from the post-office department of the United States for carrying the mails upon the road after the trustees had taken possession, and the agent claimed to be entitled to set off a note given by the company to him while in their service, before the default, and which had not matured at that time. The right of the trustees to the earnings of the road was declared to be absolute from the time they took possession, and therefore the agent could not make any offset of such note.[55]

§ 306. **Trustees for bondholders retain their trusts so long as it has not been fulfilled,** and any part of the subject-matter of the trust remains to be disposed of, unless they have been discharged, or in some way incapacitated from executing their trust. The trustees of the Western Vermont Railroad, having by a strict foreclosure gained an absolute title in trust for the bondholders, leased the road for a term of years, and at the expiration of the lease brought suit upon the covenants of the lease. It was objected, however, that before the expiration of the lease a new corporation was organized by a majority of the bondholders of the defunct corporation, under the laws of Vermont, who had converted their bonds into stocks, and that the new corporation was, by the provision of the statute under which it was formed, substituted as trustee for the other bondholders in place of the plaintiff in error, and had thus become the real party in this suit.[56]

the property, the purposes desired to be accomplished, and the mode provided for that end. The chief inquiry was, whether the functions imposed by the trust ceased upon the foreclosure, and there remained nothing further to be done except to convey the estate to the bondholders.

[55] Murray v. Deyo, 10 Hun (N. Y.), 3.

[56] Knapp v. Railroad Co. 20 Wall. (U. S.) 117, 122. "Manifestly," said Mr. Justice Davis, "it is not in the power of a state legislature, without the consent of the cestuis que trust, to substitute a new trustee in place of the persons named in the mortgage. This would impair the obligation of the contract. The salability of railroad bonds depends in no inconsiderable degree

§ 307. Mortgage trustees in possession are liable as common carriers to the same extent that the corporation itself would be liable. Unlike receivers in possession they are liable for the negligence of those employed in operating the road whereby damages occur to property or injuries happen to persons. They are merely the agents of the bondholders, and can claim no immunity by reason of holding an official position.

Trustees in possession under a mortgage of a railroad, its property and franchises, for a breach of condition, are liable in damages, under a statute making railroad corporations responsible for injuries to land upon the line of the railroad from fire caused by a locomotive engine. When such a mortgage is duly made with legislative authority, the trustees to whom it is executed stand in the place of the corporation, vested with all the rights and subject to all the liabilities incidental to the exercise of the franchise and the operation of the railroad.[57] The liability for damages in such case does not depend upon proof of negligence or malfeasance, but is an incident to the running of the road, and may be considered a part of the running expenses, and therefore an equitable lien upon the funds in the hands of the trustees.[58]

The mortgage trustees of a railroad company in possession and operating the road in the name of the company are liable to be sued for matters occurring under their management in that name. Mortgage trustees in possession of a railroad, and exercising the functions of the corporation, who were selected by the corporation as well as by its bondholders, may be regarded as the agents of the corporation in transactions with third persons, and the latter may sue the corporation and recover damages without making the trus-

upon the character of the persons who are selected to manage the trust. If these persons are of well-known integrity and pecuniary ability, the bonds are more readily sold than if this were not the case. It is natural that it should be so, and on this account the trustees usually appointed in this class of mortgages are persons of good reputation in the cities where these bonds are likely to sell. To change them is to change the contract in an important particular, and this cannot be done without the consent of the parties for whose benefit the trust was created."

[57] Daniels v. Hart, 118 Mass. 543; Stratton v. European &c. R. 76 Me. 269.

[58] Stratton v. European &c. R. 76 Me. 269.

tees parties.[59] When such trustees have defended a suit brought in the corporate name of the company, and have given no public notice of any change in the name by which they carried on the business, it is too late for them to say that they had another name.[60] The trustees have an undoubted power in the nature of a franchise to discharge their public duty by keeping the road in repair and operating it, and for this purpose they may use their own names or adopt any other convenient business name; and they are under no necessity of adopting the name of the company; and if they do, they cannot object to a suit against them by the name they use.[61]

IV. *Removal of Trustees and Filling of Vacancies.*

§ 308. A court of equity may remove a non-resident trustee of a railroad mortgage and appoint another in his stead, by an *ex parte* proceeding, when service upon the absent trustee is impossible, and the action of the court is invoked for the purpose of preserving the mortgaged property; and the fact that the absent trustee is within the territory of a country at war with the country in which the court is sitting not only does not prevent the exercise of this power, but furnishes a good reason for its exercise.[62] The Mobile and Ohio Railroad Company, incorporated under the laws of the State of Alabama, in 1853, executed a mortgage to three trustees, two of whom resided in New York and the other in Alabama, of its railroad and franchises in trust to secure bonds to the amount of $6,000,000. The mortgage also covered a land grant of one million one hundred and fifty-six thousand six hundred and fifty-eight acres of land. The deed provided that the trustees should have control of these lands, should invest the proceeds of all sales of them as a sinking fund for the payment of the bonds, and should render an account of their doings on or before the first day of January in each year. The deed also provided that if either of the trustees should die, or become incapacitated from any cause, or resign his office,

[59] Grand Tower Mfg. &c. Co. v. Ullman, 89 Ill. 244.

[60] Wilkinson v. Fleming, 30 Ill. 353.

[61] Palmer v. Forbes, 23 Ill. 301, 318.

[62] Ketchum v. Mobile &c. R. Co. 2 Woods (U. S.), 532.

then the said company, or the other trustees or trustee, might select some other person to fill the vacancy. In 1862, two of the trustees having died, the company filed a bill in the Court of Chancery for the County of Mobile, in Alabama, against the other trustee, Morris Ketchum, who was a citizen of New York, and was not a bondholder, stockholder, or officer of the railroad company, charging that he had neglected his duty as trustee, and refused to unite with the company in the appointment of new trustees; that the trust property was entirely within the Confederate States, and that he was an alien enemy; that the trust property was suffering for want of a trustee capable of acting; and that the interests of the holders of bonds secured by the trust deed imperatively demanded the appointment of trustees residing within the territory of the Confederate States, who could perform the duties incident to the trust. The bill prayed that this trustee might be removed, and that the court would fill the three vacancies by appointing new trustees. Notice of the proceedings was given by publication according to the Code of the state, and a decree was made as prayed for. The new trustees entered upon their duties and into the possession and management of the lands, and continued the trust without challenge or question until the ninteenth day of April, 1875, when two of the trustees resigned, and the remaining trustee and the railroad company, in accordance with the provisions of the deed of trust, appointed two other trustees, who entered upon the duties of the office. In May, 1875, the trustees took full possession of all the property of the railroad company for a breach of the condition of the mortgage, and filed a bill in equity to be confirmed in their possession and for foreclosure. On the fourteenth day of March, 1876, Morris Ketchum, who had in 1865 learned of his removal, but had hitherto made no claim to the office, filed a bill in which he alleged that he was the sole surviving trustee, and prayed that the property might be sold for the benefit of the bondholders, and that a receiver be appointed to take charge of the property in the mean time. Mr. Woods, the circuit judge, delivered the decision of the court,[63] in which he said that the proceedings of the court were not at any rate absolutely void by reason that service was not made upon the absent trustee, whom it was impossible to reach by notice; that the

[63] Ketchum v. Mobile &c. R. Co. 2 Woods (U. S.), 532.

court might doubtless have acted in an *ex parte* proceeding for his removal and the appointment of a new trustee; that the action of the court was at least effectual for the valid appointment of trustees to act during the disability of the surviving trustee, even without notice to him; and that the long inaction of the complainant after he learned of the decree removing him from his trust, without any attempt to assert his rights to the property, was an abandonment of any title he may have had to the office of trustee, and an acquiescence in the order of things established by the Mobile Chancery Court.

A decision inconsistent with the foregoing was rendered in Virginia, but it can hardly be regarded as authority. A deed of trust of the Alexandria and Washington Railroad Company provided that in case of the death, incapacity, or resignation of the trustee, the vacancy might be filled by an appointment to be made by any court of record in the county of Alexandria on the application of the holders of three-fifths of the bonds secured, and notice to the president or one of the directors of the company. During the War of the Rebellion the trustee, president, and directors of the company went within the lines of the Confederate forces and remained there during the war. In the mean time an application was made to a court of said county to appoint a new trustee; and a trustee was accordingly appointed without giving notice, but upon affidavit that no officer or agent of the company could be found upon whom notice could be served. The new trustee proceeded to sell the property under the trust deed. The Military Court of Appeals of Virginia held the appointment void for want of proper notice.[64]

§ 309. A trustee under a railroad mortgage who voluntarily removes to a foreign country and becomes a resident there incapacitates himself from discharging the duties of his office, and may be enjoined from acting as such trustee, and from further prosecuting an action in that capacity. The Milwaukee and St. Paul Railway Company executed a mortgage to two trustees, one of whom died, and the duties of the trust, by the terms of the deed, devolved upon the surviving trustee. The deed provided for the removal of the

[64] Washington &c. R. Co. v. Alexandria &c. R. Co. 19 Gratt. (Va.) 592; 100 Am. R. 710.

trustees, or either of them, by a vote of a majority in interest of the holders of the bonds, at any meeting called for that purpose; and in case of the death, removal, resignation, incapacity, or inability of both or either of the trustees, it was further provided that a majority of the holders of the bonds might designate and select, in writing, one or more competent persons to fill the vacancy. The Farmers' Loan and Trust Company was accordingly so selected in place of the surviving trustee, upon the assumption that he had permanently removed from the state and become a resident of France, he having resided there for upwards of ten years, with the exception of slight intervals spent in this country. The evidence established the charge of non-residence. The trust conferred was personal, and incapable of delegation. Such a trustee is generally selected because of confidence in his integrity and capacity, and especial fitness for the duties imposed by the trust. With these obligations resting upon him, the court declared that a permanent residence abroad, or even a temporary residence which rendered the full discharge of the duties of the trust uncertain, would revoke the trust, and therefore held that his removal was, *prima facie,* authorized, and that he should be restrained from acting as trustee, and from prosecuting any action in his name as trustee.[65]

Under a deed of trust which provides that in case of the absence of the trustee from the state when required to act, another person shall be his successor, or another person shall be chosen as his successor, a mere casual or temporary absence is not intended, but a prolonged or permanent absence.[66]

But any citizen of the United States has the right to hold property in trust or for his own benefit in any state; and a state statute, which declares a conveyance in trust of real or personal property to a non-resident of the state invalid, is void as to citizens of the United States, it being in violation of the constitutional provision that "the citizens of each state shall be entitled to all the privileges and immunities of citizens of the several states.[67]

[65] Farmers' &c. Co. v. Hughes, 11 Hun (N. Y.), 130; Hughes v. Chicago &c. R. Co. 15 J. & S. (N. Y.) 531.

[66] Equitable Trust Co. v. Fisher, 106 Ill. 189.

[67] Farmers' &c. Co. v. Chicago &c. R. Co. 27 Fed. 146.

§ 310. A minority of the bondholders may take proceedings for the removal of trustees for violations of duty, and the latter will not be allowed, in another court or another department of the same court, to enjoin such bondholders on the ground that they are improperly resisting a plan of reorganization approved by a large majority of all the bondholders; and this rule will be applied even though the trustees offer, in their action, to perform such parts of the trust as they are charged with having neglected. The question raised in the bondholders' suit is, whether the trustees should be allowed to act at all; and though they are only a minority, they are entitled to have the question fairly considered and determined upon its merits.[68]

§ 311. A trustee under two railroad mortgages will not be removed for the reason that he declines to employ counsel, for the foreclosure of the first mortgage, selected by a majority of the bondholders under that mortgage, and also declines to elect to act as trustee under one of the mortgages only, and to resign his trusteeship under the other. It does not avail that the application is made by a majority of the bondholders, for they have no absolute right to demand a removal. A removal will not be made without sufficient grounds.[69] Such complaints do not affect the character of the trustee for integrity. It may be that he is acting with sound judgment in declining to act separately in foreclosing either of the mortgages upon the default which has occurred. The question whether the road shall be sold under foreclosure in parcels, according to the portions included in the two mortgages, is probably one of nice discretion, to be judicially determined by the court with reference to the effect of the sale upon the interests of the bondholders under both mortgages, and upon the stockholders as well.

§ 312. A statute providing that in case a railroad be in possession of trustees under a mortgage, the bondholders may annually nominate a board of five trustees, and present their proceedings to a chancellor for the purpose of obtaining a decree confirming the nomination of the new trustees, and of transferring the property

[68] Farmers' &c. Co. v. McHenry, 9 Abb. N. C. (N. Y.) 235.

[69] Beadleson v. Knapp, 13 Abb. Pr. N. S. (N. Y.) 335.

from the old to the new trustees, impairs the obligation of contract contained in a mortgage, made prior to the statute, which provides for a succession of trustees by empowering the surviving trustee to fill any vacancy, and upon his failure so to do gives the railroad company a right to apply to a court of chancery for the appointment of trustees; and consequently such a statute is in this respect repugnant to the provision of the Constitution of the United States which prohibits a state from passing any law impairing the obligation of a contract.[70] The effect of the act was to confer upon the chancellor the right to control not only the equitable interests of the bondholders, as well as of the railroad corporation, but also the legal title in the trustees; and this is while the trust is still an active one, involving active duties on the part of the trustees, and while they have personal claims upon the trust property for indemnity for advances made and liabilities incurred. It was, moreover, a matter of election with the bondholders that they have become such, with the trustees the railroad company had constituted, and with the trusts specified in the deed, including the power of perpetuating the board of trustees. The bondholders, too, had an interest in the personal administration of the trust by the trustees named in the mortgage, and those who should be appointed in pursuance of the power therein contained. The trustees themselves had certain vested rights secured to them by the deed, and a legal interest in their office, and they cannot be divested except by due course of law. The railroad corporation itself had an interest in the administration of the trust; and the law will not be allowed to impair their vested rights.

§ 313. **Where it is provided that any vacancies in the board of trustees under such a mortgage shall be filled from the bondholders,** an election of persons who have qualified themselves for the purpose by procuring bonds is valid unless fraud was intended.[71] Neither does such a trustee discharge himself or disqualify himself from executing the trust by subsequently parting with the bonds required as a qualification.[72] He cannot, after acceptance of the trust, dis-

[70] Fletcher v. Rutland &c. R. Co. 39 Vt. 633.

[71] Richards v. Merrimack &c. R. Co. 44 N. H. 127.

[72] Richards v. Merrimack &c. R. Co. 44 N. H. 127.

qualify himself by his own act. He can only be discharged by virtue of a special provision in the deed creating the trust, or by decree of a court of competent jurisdiction; unless, perhaps, it be with the general consent of all persons interested in the execution of the trust.

The provisions of a trust deed for the appointment of a successor in the trust must be strictly followed, to render the acts of the successor valid.[73]

One claiming to be a successor in the trust can do no act as trustee until there is a vacancy in the trust, and he is duly appointed to fill it. If one is designated by the deed as successor in the trust, he has no power to act until there is a vacancy, and a notice of sale given by him before there is a vacancy is invalid; and it is not made valid by antedating the declination of his predecessor so as to make it appear that it was given before the new trustee began to act.[74] If the trust deed provides that the trustee shall advertise and sell when so requested by the holders of the indebtedness secured, he cannot act until he has received such request; and though he receives such request before the sale, but not until notice of sale has been given, the sale will be void.[75] A trust is never permitted to fail for lack of a trustee.[76]

But if the mode of filling a vacancy prescribed by the mortgage provides for an approval by a judge of a court named, there is no occasion for giving notice to the mortgagor of the application for approval.[77]

§ 314. **When a trust mortgage provides that any vacancy occurring in the board of trustees shall be immediately filled,** and the intention is apparent that the board shall always be kept full, no proceedings can be taken by the trustees or any of them while there is a vacancy in the board; they cannot take possession of the mortgaged property, or bring suit to foreclose the mortgage. If a

[73] Equitable Trust Co. v. Fisher, 106 Ill. 189.

[74] Equitable Trust Co. v. Fisher, 106 Ill. 189.

[75] Equitable Trust Co. v. Fisher, 106 Ill. 189.

[76] Farmers' &c. Co. v. Chicago &c R. Co. 27 Fed. 146.

[77] Macon &c. R. Co. v. Georgia R. Co. 63 Ga. 103.

suit has already been commenced when a vacancy occurs, it does not thereupon abate, but must be postponed until the vacancy is filled.[78]

§ 315. Mortgage trustees who act in good faith, though erroneously, are not generally individually liable. The trust deed usually provides that a trustee shall not be personally answerable except for his own wilful default or neglect.[79]

V. *Statutory Provisions Regulating the Duties of Mortgage Trustees and the Choosing of New Trustees.*

§ 316. In the New England States there are statutes which prescribe more or less fully the duties of trustees under railroad mortgages, and provide for the choice of new trustees at stated times, or upon the happening of vacancies. Such statutes, so far as they provide for the rights and duties of trustees of a corporation, relieve the parties from providing therefor in each mortgage executed.[80] These statutes are referred to, as they are essential and important parts of the law in these states governing railroad mortgages.[81]

[78] Shaw v. Norfolk County R. Co. 5 Gray (Mass.), 162.

[79] Hollister v. Stewart, 111 N. Y. 644; 19 N. E. 782; Stratton v. European &c. R. 74 Me. 422; Black v. Wiedersheim, 143 Fed. 359.

[80] Mercantile Trust Co. v. Portland &c. R. Co. 10 Fed. 604.

[81] **Maine**: R. S. 1883, ch. 51, §§ 85–92.

New Hampshire: G. S. 1878, ch. 165.

Vermont: R. L. 1880, §§ 3453–3456.

Massachusetts: P. S. 1882, ch. 112, §§ 66–70. For original statute, see Acts 1857, ch. 178.

Rhode Island: P. S. 1882, ch. 178, § 11.

Connecticut: G. S. 1888, §§ 3573–3580.

CHAPTER XI.

PAYMENT AND REDEMPTION.

I. Stipulation for payment in gold or currency, §§ 317–318.
II. Changes in form and amount of debt, §§ 319–326.
III. Payment of lost bonds, § 327.
IV. Subrogation, §§ 328–334.
V. Redemption, §§ 335–337.

I. *Stipulation for Payment in Gold or Currency.*

§ 317. It is well settled that a provision for the payment of bonds or coupons in gold coin is valid and may be enforced.[1]

The State of Alabama, by an act of its legislature in 1867, authorized its governor "to indorse in behalf of the state the first mortgage bonds of any railroad company in the state having completed and equipped twenty continuous miles of railroad, at the rate of $12,000 per mile for each section so completed and equipped." The bonds of the company bearing interest at a rate not exceeding eight per cent., so indorsed by the governor, are declared to have priority in favor of the state over any and all other liens whatsoever. The Montgomery and Eufaula Railroad Company took advantage of this act, but did not execute any trust deed or mortgage of its property to secure its bonds, the state relying upon its statutory lien. The indorsement by the governor referred to the act providing for it as his authority. The company having defaulted its interest, the holders of a part of the bonds brought a suit in behalf of themselves

[1] Trebilcock v. Wilson, 12 Wall. (U. S.) 687; Pollard v. Pleasant Hill 3 Dill. (U. S.) 195; Missouri v. Hays, 50 Mo. 34; 11 Am. R. 402. See 2 Jones Mortg. § 901.

and all other bondholders who might come in, praying that they might be subrogated to the lien and rights of the state upon the property of the company, that the lien might be established and the property and franchise of the company sold. It was, however, claimed that the indorsement was void, and consequently that there was no statutory lien, because, while the statute only authorized the indorsement of bonds bearing eight per cent. interest, the bonds issued and indorsed in this case bore eight per cent. interest in gold; that the agreement to pay the interest in gold was an agreement to pay more than eight per cent. interest. But the court held the fair construction of the statute to be that the interest might be made payable in any legal tender currency; and that whether gold might be at a premium or at a discount in respect to the treasury notes of the United States was immaterial, as both are equally lawful money.[2]

§ 318. Under the legal tender acts, an undertaking to pay in gold must be either express or implied from the contract; the implication cannot be gathered from the mere expectations of the parties.[3] The State of Maryland, having a large interest in the Baltimore and Ohio Railroad Company, to enable it to finish its road, loaned it sterling bonds of the state, with interest at five per cent. per annum, payable in London. This interest the state was, of course, obliged to pay in gold. The railroad company, by way of indemnity, agreed to pay interest to the state out of the profits of the road at a specified rate, and in parts of the contract it appeared that a complete indemnification was specifically and carefully provided for. At the time the contract was made, there was no difference existing or anticipated in the value of currency and coin; but after the passage of the legal tender acts, the interest which the railroad company stipulated to pay, if paid in legal tender notes, would fall very much short of indemnifying the state for its payment of the interest upon its bonds in gold. The question, therefore, arose whether, by the contract between the parties, the state was entitled to demand in gold what was payable to her, or whether it might be satisfied in legal

[2] Young v. Montgomery &c. R. Co. 2 Woods (U. S.), 606. And see Butler v. Horwitz, 7 Wall. (U. S.) 258; Meyer v. Muscatine, 1 Wall. (U. S.) 384, 391.

[3] Knox v. Lee, 12 Wall (U. S.) 457. See Jones Mort'g. § 901.

tender notes. The Supreme Court of the United States held that no implication of an undertaking to pay in gold could be drawn from the fact that, unless the contract should be so interpreted, there was no complete indemnification of the state.[4]

II. *Changes in Form and Amount of Debt.*

§ 319. A change in the form of the mortgage debt, such as the substitution of new bonds for those originally secured by it, does not extinguish or affect the lien.[5] A railroad company having executed a mortgage to secure a limited amount of bonds, afterwards executed another mortgage of the same property to secure a larger amount of bonds, and the deed recited that the holders of the bonds secured by the original mortgage had agreed to surrender the same, and receive in their place new bonds to be secured by the original mortgage as modified by the second mortgage. Accordingly, all the bonds secured by the first mortgage, except twenty, were exchanged for bonds secured by the second. Upon the foreclosure of this mortgage, the holders of these twenty bonds claimed to have priority over all the new bonds issued to take up the original bonds, and that they should be paid in preference out of the proceeds of the sale. They based their claim upon the theory that the new bonds issued in lieu of the original bonds were in no way secured by the original trust deed, but were a lien upon the property only by virtue of the second deed. But the court declared that the provisions of the latter deed clearly revealed the purpose of the parties, that the bondholders surrendering their original bonds for the new ones should not lose any right or estate granted by the first deed, except so far as that was modified by the second; and that the bondholders consented to give up their old bonds and take the new ones upon this express condition; and therefore the court held that the holders of these twenty bonds were not entitled to be paid out of the proceeds of the sale in preference to the holders of the substituted bonds, but that

[4] Maryland v. Railroad Co. 22 Wall. (U. S.) 105.

[5] Stevens v. Mid-Hants R. Co. L. R. 8 Ch. 1064; Gilbert v. Washington City &c. R. Co. 33 Gratt. (Va.) 586; Mowry v. Farmers' &c. Co. 76 Fed. 38, citing text.

they could not be prejudiced by the increase of the number of bonds secured by the second mortgage, and consequently were entitled to the same proportion of the proceeds of the mortgaged property that they would have had if the second mortgage had not been executed.[6]

The discharge of a prior mortgage and the taking of a later one in its place is held not to affect the rights of bondholders secured by the earlier mortgage, a discharge being always treated as an assignment when justice requires such a course. Where attaching creditors have not done or omitted to do any act relying upon a recorded discharge, they cannot complain because the transaction is given the effect intended by the parties.[7]

§ 320. But if a bondholder gives up his bonds and accepts other securities in their place, there is, in the absence of any agreement governing the transaction, a novation of the debt, a payment of the former obligations, and a substitution of the latter.[8]

Where mortgage bonds are surrendered under an arrangement for scaling down the company's indebtedness, a bondholder who has received new bonds for all except a small portion of the reduced indebtedness, there being no bond for the fractional part of a thousand dollars, his claim for this amount stands on the same footing as the indebtedness secured by the new bonds; and upon a foreclosure of the new mortgage he has the same lien for his entire claim.[9]

§ 320a. An accepted offer to give bonds secured by mortgage in place of existing debentures cannot be withdrawn by the debtor. A deposit of debenture bonds with the new trustee under the mortgage, in pursuance of a vote of the company offering the exchange,

[6] Ames v. New Orleans &c. R. Co. 2 Woods (U. S.), 206.

[7] International &c. Co. v. Davis &c. Co. 70 N. H. 118; 46 Atl. 1054.

[8] Fidelity &c. Co. v. Shenandoah &c. R. Co. 86 Va. 1; 9 S. E. 759; 19 Am. St. 858. Where bonds were exchanged for others covering an extension of a railroad, it was decided that holders of the old bonds who accepted the exchange should have the benefit of the new bonds on the extended line of the road not covered by the old bonds and also the benefit of the old bonds as collateral for themselves and other holders of new bonds. Central &c. Co. v. Marietta &c. R. Co. 73 Fed. 589.

[9] Blair v. St. Louis &c. R. Co. 23 Fed. 524.

is a sufficient acceptance. The debenture holder having delivered up his bonds and perfected his right to an exchange while the offer yet remained open, a subsequent withdrawal of the offer does not defeat his right to have the exchange completed.[10]

§ 321. When the amount of a mortgage is limited to a definite sum, this cannot be enlarged either by the mortgagor or by the trustees of the bondholders, or by a court of equity, so as to make it security for an additional sum. The La Crosse and Milwaukee Railroad Company executed a mortgage to secure $4,000,000 of its bonds, which were all issued. Upon a foreclosure of the mortgage, many of the bonds having been issued at a large discount, a decree was entered for only the amount which had been actually given for the bonds, namely, about $2,800,000. A party who had sold to the company a large amount of railroad iron and had received in payment for it bonds at eighty per cent., with an agreement that if the company should at any time sell other bonds at a less rate he should have as many additional bonds as would pay him for the iron in full, estimating the bonds already given and those to be given at the lowest rate at which any bonds had been sold, claimed that, inasmuch as the company had sold bonds at forty per cent., he had a right to have his outstanding equity with the company adjusted in the foreclosure suit, and his demand attached to the mortgage. His petition was, however, denied by the Supreme Court of the United States.[11]

[10] Wakefield &c. Co. v. New England Trust Co. 175 Mass. 478; 56 N. E. 703.

[11] Vose v. Bronson, 6 Wall. (U. S.) 452, 455. Mr. Justice Davis, delivering the opinion of the court, and stating the reasons for not adjusting his claim in this way, said: "To do this, there must be a power somewhere to enlarge the mortgage, and where is it lodged? Certainly not with the trustees, for their duty is to see that the security held by them for their cestuis que trust is enforced according to the terms of the deed. They could neither enlarge the mortgage, nor consent to its enlargement. The court could not do it, nor the La Crosse Company, as it had covenanted with the trustees in behalf of the bondholders that it would only issue four millions of dollars in bonds. The rights of the bondholders were fixed by the terms of the mortgage. The value of the bonds as an investment depended in a great measure on the number to be issued, and, doubtless, each purchaser before he bought had in-

§ 322. The debt secured cannot be increased as against subsequent incumbrancers without their consent.[12] The trustees of a subsequent mortgage could not bind the bondholders by giving such consent, nor would the consent of a majority of the bondholders bind the minority. Any one bondholder can insist upon his right that the prior incumbrace shall remain unchanged.

The Atlantic and Great Western Railway Company, incorporated under the laws of the States of Ohio, Pennsylvania, and New York, and owning a railway extending through portions of each of these states, made a first mortgage of the division of its road situate in Ohio, and afterwards a second mortgage of all its property situate in the three states. Upon the latter mortgage a foreclosure suit was brought in each of the three states. An agreement was afterwards made between the trustees of the first mortgage, sanctioned by a majority of the bondholders under it, with the trustees of the second mortgage, extending the time of payment of the first mortgage for three years, and changing the interest payable during such extended term from currency to gold. This agreement expressly provided that it was not to take effect until it was confirmed by the courts in each of the three states. It was confirmed in Ohio, but when it was pre-

formation of the character of the security on which he relied. The property might be very well a safe security for four millions of dollars, and very unsafe for any additional amount. The doctrine contended for would utterly destroy the marketable value of all corporate securities.

No prudent man would ever buy a bond in the market if the provisions made for its ultimate redemption could be altered without his consent. But it is said, as the court rendered a decree for less than the face of the bonds, equity will step in and allow the appellant to apply the vacuum of principal secured by the mortgage to liquidate his claim. The answer to this is, that it does not concern the appellant whether the court rightfully or otherwise reduced a portion of the bonds. The bondholders, whose bonds were thus reduced, are the only parties in interest who could have just cause of complaint against the action of the court, and if they did not feel aggrieved, no other person has any right to complain. The security of the mortgage extended to four millions of bonds only, and whatever amount the court should ascertain was due on those four millions was the amount secured, and no more."

[12] See 1 Jones Mortgages, §§ 357, 361.

sented for confirmation to a judge of the Supreme Court of New York, he held that he had no power to sanction any change in the effect or terms of the first mortgage.[13]

§ 323. An extension of the time of payment of a prior mortgage does not impair the security of subsequent incumbrancers.[14] A change in the time of the payment of the interest of the prior mortgage, so long as the rate is not increased, does not have this effect. Thus, a trustee under a railroad mortgage, being about to apply for an order to sell the property under the mortgage, a receiver in possession of the property, in behalf of second mortgagees, agreed to pay the interest quarterly instead of semi-annually, and thus ob-

[13] Taylor v. Atlantic &c. R. Co. 55 How. Pr. (N. Y.) 275, 279. "The court has no authority which would permit it to take that difference (between interest in currency and in gold), for a period of three years, from the holders of the second mortgage bonds and give it to the more fortunate owners of the first, against the objections of those resisting the proceedings. The same principle which would sanction a small increase of the prior incumbrance would sustain one which might prove entirely destructive to those designed to be protected by the succeeding incumbrance; and if the court had the power over the agreement of the parties to change it in any material respect, it could entirely destroy its value. The point involved is one of principle solely, for if the power exists it can be limited in its application only by the subject to be affected by it. Every bondholder is equally entitled, by the agreement made with him, and with the trustees for his benefit, to be protected in all the advantages legally secured by it; and for that reason the courts cannot disregard the principle protecting him, because the amount due to him and the extent to which he may be entitled to participate in the advantages of the security may be, comparatively speaking, not very significant. It is enough that a material right may be prejudiced, and the party deprived of the full advantage of his contract and security, to require that the court shall not interpose to his manifest injury; and such a right has been clearly shown in this case." Per Daniels, J., in Taylor v. Atlantic &c. R. Co. 55 How. Pr. (N. Y.) 275, 279. An injunction against the carrying into effect of this agreement was granted by another judge of the same court, and continued pendente lite. Reinach v. Meyer, 55 How. Pr. (N. Y.) 283. It may be observed, moreover, that no confirmation of such agreement could give it any validity as against a bondholder who did not himself consent to it.

[14] 2 Jones Mortgages, § 942.

tained an extension of the mortgage. A holder of receivers' certificates, which were by agreement and order of court made a lien subject to the first mortgage, could not object to the payment of the interest as agreed.[15]

§ 324. The purchase of bonds under a sinking fund provision may be a payment of them so far that they cease to be a part of the corporate debt; but the obligation of the corporation for the payment of interest on such bonds continues under the provisions of the mortgage. Thus, where a mortgage provided that the company should pay a certain sum twice each year to the mortgage trustees, with which and the accumulations of interest thereon the trustees should purchase outstanding bonds so long as they could be purchased at not more than ten per cent. above par, the bonds so purchased to remain in force so that the company should pay interest thereon, the amount of such interest to be added to the capital of the sinking fund, the fact that the price of the bonds had advanced beyond the permitted purchase price was held not to release the company from the obligation of continuing the payment of interest upon the bonds purchased for the sinking fund. The advance in the price of the bonds beyond the purchasing price operated only as a partial suspension of the operation of the sinking fund; the suspension of it extended no further than the fair construction of the mortgage required.[16]

§ 325. A company may purchase its own bonds as an investment, and reissue them. If the facts show that there was no intention of paying the bonds, but they were regarded and reported by the company as still outstanding, they are valid in the hands of a subsequent purchaser and are secured by the lien of the mortgage.[17]

The purchaser of such reissued bonds, for a new and ample consideration, is not liable to the creditors of the corporation for the value of the bonds, although the corporation, without the knowledge of the purchaser, was, at the time of such purchase, in the hands of a receiver.[18]

[15] United States Co. In re, 55 How. Pr. (N. Y.) 286.

[16] Wilds v. St. Louis &c. R. Co. 102 N. Y. 410; 7 N. E. 290.

[17] Fifty-four First Mortgage Bonds, In re, 15 S. Car. 304.

[18] Williams, Ex parte, 18 S. Car. 299.

§ 326. Bondholders are not obliged to accept payment until their bonds are due by their terms. A railroad company having executed bonds payable in thirty years made a traffic contract with another company by which it was agreed that the latter should retain the share of the earnings under the contract belonging to the former and pay them over to a trustee, to be applied to the redemption of the bonds, the contract to continue in force for thirty years, "or for so long a time as will be sufficient to provide a fund large enough to redeem all of said bonds." This agreement was indorsed on the bonds. It was held that this agreement did not give the railroad company the right to pay off the bonds before the expiration of the thirty years, though a sufficient fund for that purpose had sooner accrued. There was nothing in the agreement to control the express stipulation in the bonds that the bonds should be paid in thirty years.[19]

§ 326a. Payment before the day cannot be enforced by either party. Where a mortgage is payable at a day certain, while on the one hand the mortgagor cannot be called upon before that day to make payment, on the other the mortgagee cannot be called upon before that day to receive payment, unless, perhaps, there be tendered, in addition to the principal sum all the interest that would accrue up to the day fixed for payment. An agreement that the mortgagee shall accept payment of part of the principal debt before the whole is due if tendered at stated times, as, for instance, when interest is payable, does not bind the mortgagee to accept such payments of the principal at any other time. If the interest is payable semi-annually on days named in the mortgage, the mortgagee is bound to accept payments of the principal upon those days, and only upon those days.[20]

Under an agreement for the making of a sinking fund and the retirement of certain bonds drawn by lot, the terms of the agreement must be strictly followed or the right to retire bonds will be lost. Each bond has an equity represented by the chance that it may not be drawn by lot for redemption until it becomes payable. As bonds may draw a high rate of interest, that equity is valuable, and

[19] Chicago &c. R. Co. v. Pyne, 30 Fed. 86.

[20] Jones Mortgages, 6th ed. § 888.

each bondholder has a right to insist that his bond shall not be redeemed except in strict accordance with the contract contained in the mortgage. Whatever the mortgagor has done outside of the contract, by way of paying or acquiring bonds cannot be considered as done under the contract or in any way credited upon the sinking fund clause. That clause cannot be enforced upon any basis less favorable to the outstanding bondholders than if the contract had been performed instead of violated.[21]

III. *Payment of Lost Bonds.*

§ 327. The loss of a bond is no objection to the payment of it by the company that issued it, provided proper indemnity be furnished against its being enforced in the hands of others.[22] Relief is given in equity. Equity jurisdiction in the case of lost bonds originates in the doctrine of profert at common law, it being a rule of pleading in the common law courts that they could give no remedy for a debt secured by bond unless the creditor offered to produce his bond in court. If the bond were lost, profert was impossible, and the remedy at law was gone. A court of chancery, however, on proof that the bond was lost, entertained jurisdiction to compel its reexecution and payment of the money secured. Now, although profert is dispensd with, the equity jurisdiction survives.[23]

Relief for the loss of negotiable bonds will only be given upon the condition that full and secure indemnity be given against all risk. The difficulty of securing full and complete indemnity to meet all the contingencies that may occur when the bonds have a very long time to run may be great, but it does not prevent the granting of the relief. The court has full control of the matter. Indemnity should be furnished upon each payment of interest, as well as upon the payment of the principal sum; and then, if at

[21] Missouri &c. R. Co. v. Union Trust Co. 156 N. Y. 592; 51 N. E. 309, affirming 87 Hun, 377; 34 N. Y. S. 443; Barry v. Missouri &c. R. Co. 34 Fed. 829.

[22] Miller v. Rutland &c. R. Co. 40 Vt. 399; 94 Am. Dec. 413. See § 220.

[23] New Orleans &c. R. Co. v. Miss. College, 47 Miss. 560; and see Lawrence v. Lawrence, 42 N. H. 109.

any time before final payment it be made to appear that the indemnity for past payments was insufficient, or had become insecure, the court might properly make it a condition precedent to the receipt of further payments that additional indemnity be given in respect to payments previously made. With proper precaution all risk may be provided against; and if the bonds should be discovered, or be presented by a *bona fide* holder, of course the obligations issued in their place will cease to be of value.[24]

IV. *Subrogation.*

§ 328. Subrogation arises by operation of law, as a general rule, whenever the mortgage debt is paid by one entitled to redeem, other than the debtor. It is an equitable right, and of course there is no chance for its operation when there is a legal right to the security, such as exists when a legal assignment of the security is taken by the person paying the mortgage debt. Subrogation proceeds upon the theory that the mortgage debt has been paid, and paid by one who has the right to redeem, and under circumstances which entitle him, as an equitable assignee of the security, to hold it as a subsisting charge upon the property. It does not matter whether the creditor who pays such debt does so voluntarily or for his own protection. It is an essential condition, however, of his right to substitution, that he is himself under no obligation to pay such debt; that it is not in any way a debt of his own. This principle is often available for the protection of one who has paid off an incumbrance upon property to which he erroneously supposed he had good title, enabling him, upon the failure of his title to the equity of redemption, to hold the mortgage title as an equitable assignee.[25]

There is no equitable subrogation where a right of substitution to the security is given by statute, though the result may be similar. Thus, where a state guaranteed bonds of a company issued in exchange for outstanding mortgage bonds, under a statute which

[24] Chesapeake &c. Canal Co. v. Blair, 45 Md. 102.

[25] See Jones Mortgages, §§ 874–885. See Newbold v. Peoria &c. R. Co. 5 Bradw. (Ill.) 367; Memphis &c. R. Co. v. Dow, 120 U. S. 287; 7 Sup. Ct. 482.

provided that the state should take and retain as security the bonds surrendered, until all the bonds should be retired, it was held that the state could assert a lien under the mortgage as security for all the bonds exchanged as of equal rank with the mortgage bonds not exchanged. The mortgage under the terms of the act was not *pro tanto* paid and discharged by the issuing of new guaranteed bonds by the state, but the lien of the transferred bonds was kept alive until the whole amount of the bonds shall be delivered up.[26]

One of several holders of bonds secured by mortgage, who purchases superior liens takes them in trust for his co-bondholders on condition that after reasonable notice, they contribute their share of the amount paid.[27]

§ 329. **Relief can be had by one who has paid a prior mortgage, under the belief that he had a good title to the mortgaged property,** only when he has made the payment under a mistake of fact, and when he has not acted in bad faith towards any parties interested in the property. The La Crosse and Milwaukee Railroad Company, having made a first and second mortgage, was sold on execution at the suit of certain creditors, and was bought in by the bondholders secured by the second mortgage. The purchasers, as they were authorized to do by statute, organized themselves into a new corporation, and worked the road for their own profit. Subsequently the mortgagees under the senior mortgage pressed their claim to a decree of foreclosure, when the new corporation, in order to prevent a sale, paid into the court the amount of the decree, and the money was distributed among the bondholders. A bill was then pending against the new corporation in behalf of certain judgment creditors of the La Crosse and Milwaukee Railroad Company, alleging that the sale under which the new corporation claimed was fraudulent and void, and praying that it might be set aside; and a decree was afterwards made in accordance with the prayer, and directed that the property should be resold, and the proceeds applied, after payment of prior liens, to the satisfaction of the judgments on which the creditor's bill was founded. The new corporation then filed a bill in equity against the mortgagees under the first mortgage, ask-

[26] Gibbs v. Greenville &c. R. Co. 13 S. Car. 228.

[27] Booker v. Crocker, 132 Fed 7.

ing to have the money returned to them, on the ground that it had been paid under a mistake of fact, or as an alternative relief to be subrogated for the benefit of the first mortgage; but the Supreme Court of the United States held that the bill would not lie for either form of relief.[28]

[28] Railroad Co. v. Soutter, 13 Wall. (U. S.) 517, 523. Mr. Justice Bradley, delivering the opinion of the court, said: "The bare statement of the claim, even presenting it in the language of the bill itself, seems to us sufficient to condemn it. Who are the complainants? Are they not the very bondholders, self-incorporated into a body politic, who, through their trustee and agent, effected the sale which was declared fraudulent and void, as against creditors, and made the purchase which has been set aside for that cause? Was it ever known that a fraudulent purchaser of property, when deprived of its possession, could recover for his repairs or improvements, or for incumbrances lifted by him whilst in possession? If such a case can be found in the books, we have not been referred to it. Whatever a man does to benefit an estate, under such circumstances, he does in his own wrong. He cannot get relief by coming into a court of equity. By the civil law, the possessor, even in bad faith, may have the value of his improvements, if the real owner choose to take them. The latter has an option to take them or to require their removal. But this rule has never obtained in the common law, nor in the system of English equity. One of the maxims of the latter system is, 'He that hath committed iniquity shall have not equity.' And various illustrations of it are furnished by the books. But the complainants are wrong in asserting that the property was not theirs. It was theirs. Their purchase was declared void only as against the creditors of the La Crosse and Milwaukee Railroad Company. In other words, it was only voidable, not absolutely void. By satisfying these creditors they could have kept the property, and their title would have been good as against all the world. The property was theirs; but by reason of the fraudulent sale was subject to the incumbrance of the debts of the La Crosse Company. This was the legal effect of the decree declaring their title void. Therefore they were, in fact, paying off an incumbrance on their own property when they paid into court the money which they are now seeking to recover back. They are wrong also in asserting that they made the payment under a mistake of fact. If it was made under any mistake at all, it was clearly a mistake of law. They mistook the legal effect of transactions of which they were chargeable with notice. They were the persons for whose benefit the purchase was made, which was declared to be fraudulent. They were the principal defendants in the

The use of funds raised by a second mortgage to pay off interest coupons of a prior mortgage and to pay operating expenses so as to keep the railway a going concern does not entitle the second mortgagee to be subrogated to the rights of the prior mortgage.[29]

§ 330. Subrogation to rights of a state.—The holders of bonds of a railroad company, which a state has indorsed under a statute giving a lien upon the company's property as security, may upon a default of the company be subrogated to the rights of the state in respect to this security, and may, in a suit to enforce the lien, obtain a sale of the property and application of the proceeds to the payment of the bonds.[30]

Although bondholders who have purchased bonds of a railroad company indorsed by a state may be subrogated to a mortgage taken by the state for its security, after the state has repudiated its indorsement as illegal, yet there can be no such subrogation by one who has taken the bonds without such indorsement, but issued to

creditors' bill upon which this decree was rendered. All the evidence in that suit had been taken when they made the payment in question. The cause was pending, on appeal, in this court. There was not a fact, therefore, of which they were ignorant. They had full and actual notice of all the transactions, and all the evidence on which the decree was ultimately founded." Moreover, as against those who had in the meantime purchased the property under the proceedings had in favor of the judgment creditors, there would be no equity in subjecting the property to an incumbrance from which it was free when their purchase was made. Chief Justice Chase and Justices Miller and Field dissenting. See, for previous stages of the litigation, Bronson v. La Crosse &c. R. Co. 2 Wall. (U. S.) 283; James v. Railroad Co. 6 Wall. (U. S.) 752; and for subsequent litigation, Barnes v. Chicago R. Co 8 Biss. (U. S.) 514, holding that the foreclosure decree was invalid only as to creditors who filed the bill to set it aside; and the bondholders who voluntarily took stock in the new company could not claim under the mortgage, nor could the mortgage trustee maintain a new bill of foreclosure for their benefit.

[29] Morgan &c. Co. v. Texas Central R. Co. 137 U. S. 171; 11 Sup. Ct. 61.

[30] Young v. Montgomery &c. R. Co. 2 Woods (U. S.) 606; Colt v. Barnes, 64 Ala. 108; Gilman v. New Orleans &c. R. Co. 72 Ala. 566; Morton v. New Orleans &c. R. Co. 79 Ala. 590; Forrest v. Ludington, 68 Ala. 1.

an officer of the company as collateral security for advances by him.[31]

§ 331. The difficulty in the way of subrogation to the security taken by a state is illustrated in a recent case before the Circuit Court of the United States for the Fifth Judicial Circuit.[32] The State of Georgia, under the authority of an act of the legislature passed in 1866, indorsed the bonds of the Macon and Brunswick Railroad Company, to the amount of ten thousand dollars per mile, upon the express condition that such indorsement should vest in the state the title of all property purchased with the proceeds of said bonds, and should give the state a first lien on all the property of the company; and that upon failure of the company to pay the interest or principal of the bonds, the governor should take possession of all its property and sell the same for the purpose of paying the bonds. Bonds to the amount of $1,930,000 were issued and indorsed by the state in accordance with this act. In 1868 the people of the state adopted a constitution, by which it was provided that the credit of the state should not be granted or loaned to aid any company, except under certain conditions. In 1870 the legislative passed an act amending the Act of 1868 above referred to, so as to authorize the governor to indorse the bonds of the company to the extent of three thousand dollars per mile in addition to the ten thousand first authorized. Under the latter act the company issued bonds which were indorsed by the state to the amount of $600,000. Two years afterwards the legislature, by resolution, declared the state's guaranty on these bonds binding upon the state. In 1873, the interest on the bonds not having been paid, the governor seized upon and took possession of the railroad on behalf of the state, and appointed an agent or receiver to manage it. In 1875 the legislature passed a resolution declaring the first issue of bonds valid and binding on the state, but the second issue of $600,000 unconstitutional, null, and void, and also declaring that the road ought to be sold. Accordingly, the governor caused the road to be advertised for sale, whereupon a holder of bonds of the last issue filed a bill in which he prayed for an injunction to prevent the sale.

[31] Clews v. Brunswick &c. R. Co. 54 Ga. 315.

[32] Branch v. Macon &c. R. Co. 2 Woods (U. S.), 385, 388, 389.

and asked for the appointment of a receiver to take possession of and sell the road under the direction of the court; but the court refused this relief, because it could not be granted without adjudicating the rights of the state, which ought not to be done unless the state were a party, and the state could not be made a party.[33]

[33] Mr Justice Bradley, delivering the opinion of the court, said: "The great difficulty in this case arises from the fact that the surety is the State of Georgia, and that the state is, by its agents and officers, in possession of the property given by way of indemnity. In order to effect the object of this bill, the state must not only be displaced and the bondholders subrogated in its stead, in reference to the property in question, but the courts must dispossess the state of the actual possession of that property. . . . . The court is called upon, therefore, to adjudicate directly upon the state's liability on the guaranty without having any jurisdiction over it as a party; and having decided in favor of that liability, it is then called upon to dispose of the fund which the state has taken for its indemnity. The case, therefore, involves a direct adjudication of the rights and liabilities of the state, and an ultimate execution of property in its possession, the state, at the same time, denying its liability, and insisting upon its right to maintain its lawfully acquired possession. It seems to us that this is asking the court to go further than any court has ever gone yet, except where legislation has been adopted authorizing the state to be sued in the same manner as a private party. At all events, the right of the complainant is, to our view, so doubtful that we do not feel authorized to exercise the extraordinary powers of this court sought to be put into operation. Without attempting, therefore, to point out to the complainant what other remedy he has, except to rely upon the good faith of the State of Georgia, we feel compelled to deny the motion for an injunction and appointment of a receiver."

A supplemental bill was filed in this case by leave of the court against the purchasers, attempting to charge the property in their hands with a trust in favor of the holders of the bonds of 1870, charging that the state had been their trustee to enforce their equitable rights and had been guilty of a breach of its trust by selling the property at a price much below the real value. It was held that the plaintiffs were not entitled to be subrogated to the mortgage security taken by the state, because the property had passed out of the possession of the state, and because the state was a necessary party to the enforcement of such claim. It was also held that the only bonds secured by the statutory mortgage were those issued in 1866, and that those issued in 1870 were not secured by it. Cunningham v. Macon &c. R. Co. 156 U. S. 400; 15 Sup. Ct. 361.

§ 332. But there can be no subrogation as against a state which has issued its own bonds to a railroad company to aid its construction, in behalf of a holder to whom the company has transferred the bonds. The state is then the principal debtor, and primarily liable, and the holder of such bonds cannot on the principle of subrogation claim to have lands conveyed to the state as security against the loss upon such bonds applied to the payment of the bonds held by him. The property is not affected by any constructive trust in behalf of the bondholders. At any rate, after the state has foreclosed the statutory lien taken for the indemnity of the state, and sold the property to innocent purchasers, the bondholders have no remedy against the property.

The State of Minnesota issued its bonds to the Southern Minnesota Railroad Company, which transferred to the state as security certain lands it had received as a grant in aid of the construction of the road, and also executed a first mortgage of all its property. The company partially graded and constructed its road, and received bonds from the state, nearly all of which, amounting to half a million dollars, it transferred to a contractor who had built the road. The company made default under its mortgage to the state, which foreclosed the mortgage, and purchased the property at the sale. Several years afterwards, the state transferred to a new corporation the property acquired under the foreclosure, together with the lands conveyed to it by the original company. The state, however, directly after the default of the Southern Minnesota Railroad Company, proved recreant to its good faith and honor by refusing to pay the interest or principal of its bonds. The contractor, after a delay of twelve years, brought a bill in equity against the new corporation which had then completed the road, seeking to charge the lands in its possession before mentioned with the payment of the bonds. The Supreme Court of the United States decided that he had no equity which could be enforced, and that, if he had had any such equity, his long delay in presenting the claim would deprive his suit of favorable consideration.[34]

[34] Chamberlain v. St. Paul &c. R. Co. 92 U. S. 299, 306. Mr. Justice Field said: "Whatever right the plaintiff had to compel the application of the lands received by the state to the payment of the bonds held by him, it was one resting in equity only. It was not a legal

§ 333. A statutory lien reserved to a state to secure its bonds loaned to a railroad company is a security for the holders of such bonds. As between the state and the company receiving the bonds, the company is the principal debtor and is bound to pay the bonds; and though the bonds be declared void as against the state, the company which negotiated them is bound to pay them to *bona fide* holders, and the latter may enforce the statutory lien reserved by the state.[35]

A satutory lien in favor of a state for the payment of certain bonds guaranteed by the state may also be a lien for the benefit of the holders of such bonds, and if such lien has once attached in favor of the bondholders it cannot be postponed or defeated by any subsequent legislation. Whether the bondholders can avail themselves of such lien or not is determined by the inquiry whether the lien was given to secure the bonds or to indemnify the guarantor. In a case where the bondholders already held a mortgage for their security, and an act was passed whereby the state proposed to the bondholders to exchange their mortgage security for a statutory lien, and they accordingly made the exchange, the terms of the act were held to constitute a contract between the state and the bondholders

right arising out of any positive law, or any agreement of the parties. It did not create any lien which attached to and followed the property. It was a right to be enforced, if at all, only by a court of chancery against the surety. But the state being the surety here, it could not be enforced at all, and not being a specific lien upon the property, cannot be enforced against the state's grantees. Where property passes to the state, subject to a specific lien or trust created by law or contract, such lien or trust may be enforced by the courts whenever the property comes under their jurisdiction and control. Thus, if the property held by the government, covered by a mortgage of the original owner, should be transferred to an individual, the jurisdiction of the court to enforce the mortgage would attach as it existed previous to the acquisition of the government. But where the property is not affected by any specific lien or trust in the hands of the state, her transfer will pass an unincumbered estate." Followed in Stevens v. Louisville &c. R. Co. 3 Fed. 673.

[35] Tompkins v. Little Rock &c. R. Co. 15 Fed. 6; 18 Fed. 344; 21 Fed. 370; North Carolina R. Co. v. Drew, 3 Woods (U. S.), 692; Daniels v. Tearney, 102 U. S. 415, 421; Florida v. Florida &c. R. Co. 15 Fla. 690; Improvement Fund v. Jacksonville &c. R. Co. 16 Fla. 708; Clews v. Brunswick &c. R. Co. 54 Ga. 315.

for a statutory lien in their behalf, although the lien was in terms a lien to the state.[36] A reservation in such act, of the right to the state to enact all laws that may be deemed necessary to protect the interests of the state, does not give the state a right to destroy or postpone the lien to the detriment of the holders of the bonds secured by the statutory lien.

§ 334. **A statutory lien in favor of a state may by the terms of the statutes be a security for the holders of the bonds** of the state issued in aid of railroad companies. Such was the case under certain legislation of the State of Florida in aid of the railroads of that state. It provided that in case of a sale by the state under the lien, the purchase money should be paid into the state treasury, and promptly and exclusively applied to the payment and satisfaction of the bonds issued by the state; and that, if the holders of the bonds did not present them within ninety days after the sale, the treasurer should invest the proceeds in securities of the United States, "to be held by the State of Florida as trustee for the bondholders," until payment of the bonds should be demanded, when the treasurer should turn over the securities to the bondholders. Chief Justice Waite, delivering the opinion of the Supreme Court, remarked that it would seem as though language could not be used indicating more clearly an intention to have the lien a security for the holders of the state bonds; and further that the intention was that, if the state paid its bonds from its own funds, the mortgage should be enforced to compel the railroad companies to make the state good for all such payments; and if the state did not pay, then that the creditors should have their own recourse upon the mortgage. Accordingly it was held in this case that, although the legislation under which the state issued its bonds in aid of the railroads was unconstitutional and the bonds void as against the state, yet, as they were disposed of by the railroad companies under such circumstances that they were regarded as coming within the rule of liability of indorsers of commercial paper, it was held that the statutory lien was not void, but that the holders of the state bonds so issued were entitled to the benefit of the lien.[37]

[36] Hand v. Savannah &c. R. Co. 12 S. Car. 314; Gibbes v. Greenville &c. R. Co. 13 S. Car. 228.

[37] Railroad Co.'s v. Schutte, 103 U. S. 118.

V. *Redemption.*

§ 335. Statutory right of redemption.—It is not often that the subject of the right of redemption from foreclosure sales under railroad and other corporate mortgages is a matter of litigation in the courts. Especially when a railroad company has become so embarrassed as to allow its property to be sold to satisfy a mortgage upon it, there is generally nothing worth redeeming, even if the corporation, or any assignee or creditor of it, should be in condition to effect a redemption requiring such a large sum of money as railroad mortgages usually represent. There are generally laws in several states allowing redemption after foreclosure sales, but they are not generally applicable to sales made by virtue of powers in trust mortgages, such as railroad mortgages usually are, although they may be applicable to sales under such mortgages when they are enforced by a bill in equity.[38] These statutes relating to redemption become a part of the contract of mortgages affected by them, made while the statutes are in force; they confer substantial rights, and become a rule of property, binding upon the federal courts sitting in equity in states where such statutes exist; and the federal courts must conform to such statutes in decrees foreclosing mortgages affected by such rights of redemption.[39]

Such statutes are not binding upon the federal courts when they are called upon to decree a foreclosure sale of a railroad mortgage which covers as an entirety the rights, franchises, and road of the company existing in several states. In the Indianapolis, Bloomington, and Western Railway case a final decree of sale was rendered in 1877. The sale had not taken place when the Supreme Court of the United States decided the case of Brine v. Insurance Company, where it was held, as to a lot of land in Chicago which had been mortgaged, that the right of redemption within fifteen months given by the Illinois statute was part of the contract which the federal court was bound to recognize. In the railroad case the decree had directed the sale of the railroad property, rights, and franchises as an entirety, without redemption, and a motion was made to correct the decree so as to recognize the right of redemption

[38] See Jones Mortgages, Chapters xxii., xxix., xxx.

[39] Brine v. Insurance Co. 96 U. S. 627.

given by the statutes of Indiana and Illinois in sales of real estate. Mr. Justice Harlan decided that the redemption statutes of Indiana and Illinois did not embrace railroad mortgages which covered as an entirety the property, rights, and franchises of a railroad, and that the original decree should stand.[40]

§ 335a. Right of junior mortgagee to redeem.—Seven years after a decree foreclosing a first mortgage, a petition was filed in a federal district court by holders of a second mortgage on the same property, praying to be allowed to redeem. This petition was based on the proposition that, in a decree which orders a sale of the property to pay the first mortgage debt, an express order cutting off the equity of redemption of a junior mortgagee, although a party to the suit, is necessary to divest the latter of his lien and of his right of redemption. The suit was carried to the Supreme Court on appeal where Mr. Justice Shiras, speaking for the court, disposed of it as follows: "We are unwilling to accept this as a sound statement of the law, or at all events to concede it as invariably true. Where a junior mortgagee is a party defendant to a foreclosure bill in which, as in the present case, there is a prayer that he be decreed to redeem, and where the priority of the plaintiff's mortgage is found or conceded, and a sale is ordered in default of payment, declaring the right of the debtor to redeem to be forever barred, we do not deem a similar order as to right of redemption by the junior mortgagee to be substantially or even formally necessary. He has, of course, a right to redeem, but if he chooses not to assert such right, and stands by while the sale is made and confirmed, he must in equity be deemed to have waived his right."[41]

§ 336. A franchise sold under foreclosure is not subject to redemption. The provisions of state statutes governing the sale of realty on judicial process, and securing to the debtor and to judgment creditors the right of redemption, are not applicable to sales of a railroad and its appurtenances, for the reason that, if they

[40] Boston Daily Advertiser, October 9, 1878; Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 380, 389.

[41] Simmons v. Burlington &c. R. Co. 159 U. S. 278; 16 Sup. Ct. 1.

were held to be applicable, the personalty and the franchise would have to be sold without redemption, while the realty would be subject to redemption, which would result in the practical destruction of the value of the whole; and upon considerations of public policy as well as of private right the real estate, franchises, rolling stock, and other property of a railroad corporation mortgaged as an entirety, may be sold as an entirety, under the decree of a court of equity, without any right of redemption in the mortgagor or in judgment creditors as to such real estate.[42] The Supreme Court of Illinois has adopted this view, and holds that the statutory right of redemption does not attach in the case of a foreclosure sale of the property and franchises of a railroad. Taken as a whole, the property is not, strictly speaking, either real or personal. Partly upon considerations of public policy, the sale of railroad property upon foreclosure should be made without any right of redemption.[43]

§ 337. **A vested right to redeem under the general law cannot be destroyed or impaired by a special statute** enacting that the mortgage has been foreclosed, or that it shall be foreclosed in case the debt be not paid within one year from the passage of the act.[44]

Under a mortgage to a state, a right of redemption to which the mortgagor is entitled after the surrender of the property to the state cannot be enforced by suit against the state in its own courts, for a state cannot be impleaded in its own courts except by its own consent clearly manifested by an act of its legislature.[45]

In New York[46] it is provided by statute that whenever default shall be made by any railroad or plank road company in the payment of principal or interest of any bonds of such company, which

[42] Hammock v. Loan &c. Co. 105 U. S. 77; 13 Fed. 189n; Simmons v. Taylor, 38 Fed. 682; Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 380, 389; Columbia &c. Co. v. Kentucky &c. R. Co. 60 Fed. 794.

[43] Peoria &c. R. Co. v. Thompson, 103 Ill. 187.

[44] Ashuelot R. Co. v. Elliot, 52 N. H. 387; Martin v. Somerville &c. Co. 27 How. Pr. (N. Y.) 161.

Where a stockholder seeks to redeem a corporate mortgage, his standing in court depends upon the actual ownership of stock. Williams v. Savings &c. Ass'n, 133 Cal. 360; 65 Pac. 822.

[45] Troy &c. R. Co. v. Commonwealth, 127 Mass. 43.

[46] 2 R. S. 1875, p. 553, § 108. Original Act, Laws 1853, ch. 502.

are secured by a mortgage of the property of such company, it shall be lawful for each and every stockholder of said company, at any time during the process of such foreclosure, to pay to the mortgagees named in such mortgage, for the use and benefit of the holder and holders of such bonds, such a proportion of the sum due, and of the sum secured to be paid by the whole of the bonds secured by such mortgage, as such stockholder's stock shall bear to the whole stock of said company; and on so paying such stockholder shall, to the extent of such payment, become and be interested in said mortgage and protected thereby.

In case of the foreclosure of any mortgage given by any railroad or plank road company to secure the payment of any bond of such company, any stockholder of such company shall, for the period of six months after the sale under such foreclosure, have the right, on paying to the purchaser or purchasers at or under such sale, or to the mortgagees in such mortgage, for the use and benefit of said purchaser or purchasers, a sum equal to such proportion of the price paid on such sale, and the costs and expenses thereof, as such stockholder's stock in said company shall bear to the whole capital stock of said company; and on so paying, such stockholder shall be entitled to have the same relative amount of stock or interest in said railroad or plank road company, and its road, franchises and other property.[47] It shall be lawful for any mortgagee of any railroad and the franchises thereof to become the purchaser of the same, at any sale thereof under the mortgage, upon foreclosure by advertisement, or under a judgment or decree, or otherwise, and to hold and convey the same, with all the rights and privileges belonging thereto or connected therewith.[48]

A sale under a decree in a foreclosure suit bars all equitable right of redemption on the part of the mortgagor, leaving only such right as may be secured by statute.[49]

[47] 2 R. S. 1875, p. 553, §§ 109–110.

[48] 2 R. S. 1875, p. 553; Laws 1857, ch. 144, § 1.

[49] Simmons v. Taylor, 38 Fed. 682.

CHAPTER XII.

REMEDIES AND JURISDICTION OF COURTS FOR ENFORCEMENT OF CORPORATE SECURITIES.

I. The several remedies to enforce corporate securities are cumulative, §§ 338–349.

II. Jurisdiction of state and federal courts of suits against corporations, §§ 350–360.

III. Effect of consolidation of railroad corporations upon the jurisdiction of suits against them, §§ 361–367.

IV. In cases of concurrent jurisdiction, the court which first assumes jurisdiction retains it, §§ 368–371.

V. Sale of franchise or property of railroad company on execution, §§ 372–380.

I. *The Several Remedies to enforce Corporate Securities are Cumulative.*

§ 338. **General Statement.**—Although for the reasons stated mortgages by railroad companies, and other corporations having property of great value widely scattered, are almost always foreclosed by suits in equity, yet other methods of foreclosure are not wholly disused. Thus, in Massachusetts, such mortgages have been foreclosed by writ of entry and possession;[1] and in Maine by notice and possession in the manner used for the foreclosure of ordinary mortgages.[2]

The general rule, that the several remedies upon a mortgage by suits at law and in equity, and by entry and possession, may be

[1] Haven v. Grand Junction R. & Depot Co. 12 Allen (Mass.), 337.

[2] Kennebec &c. R. Co. v. Portland &c. R. Co. 59 Me. 9.

used together or successively,[3] is applicable to mortgages by railway companies. A contract by a mortgagor railroad to furnish additional underlaying security for payment of the mortgage debt may be specifically enforced or if it appears that the liability exists, but performance cannot be decreed, the court should award the plaintiff such relief as it deems him entitled to.[4]

A holder of bonds issued by a railroad company and guaranteed by the trustees of an internal improvement fund acting in behalf of a state, and having a statutory lien upon the railroad as security, on the default of the company has three remedies: first, upon the personal liability of the company; second, upon the guaranty of the internal improvement fund; and, third, upon the statutory lien on the railroad. He cannot avail himself of the latter directly, as he could if it were a mortgage given to secure the bonds alone; but he must induce the trustees to act in the mode pointed out by the statute, or compel them to act by mandamus; or he may seek relief by a bill in equity.[5]

§ 338a. **A guarantor of the debt of a corporation, as collateral security for which mortgage bonds of the corporation are deposited,** is not released from his contract of guaranty by a foreclosure of the mortgage. The bonds were never evidence of the principal debt from the corporation, but were held subject to a right of redemption, the debt guaranteed was not the mortgage debt or any part of it, and it still remains unpaid. A mere change in the form of the collateral security, under a power which goes with the security as part of it, has no effect upon the debt secured by the collateral. The continued holding of the security whether in its original form or in a changed form, does not affect the right to proceed on the guaranty.[6]

[3] 2 Jones Mortgages, § 1215; Macon &c. R. Co. v. Georgia R. Co. 6 Ga. 103; 50 Am. Dec. 318.

[4] O'Beirne v. Allegheny &c. R. Co. 151 N. Y. 372; 45 N. E 873, affirming 80 Hun (N. Y.), 570; 30 N. Y. S. 588.

[5] Florida v. Anderson, 91 U. S. 667.

See Wheelwright v. St. Louis &c. Co. 56 Fed. 164, where a provision allowing the trustee to take possession on default was declared by the trust deed to be merely cumulative.

[6] Lee v. Butler, 167 Mass. 426; 46 N. E. 52; 57 Am. St. 466.

§ 339. Although a mortgage itself provides no remedy other than a power of sale, the jurisdiction of a court of chancery to enforce it is not ousted. The power of sale is only a cumulative remedy.[7] Although a mortgage provides several remedies, as for instance that the mortgagee may, upon default, take possession and apply the income of the property to the payment of the debt secured, or may sell the property under a power, or may enforce payment of the debt by suit at law, or may enforce the security by proceedings in equity, the mortgagee is not confined to any particular order of priority in resorting to one or all of the remedies conferred by the mortgage.[8]

Whether a provision in a mortgage making a sale by the trustees under the power given them, exclusive of all other methods of sale, would exclude a resort to proceedings in equity by bondholders for that purpose, is perhaps an undecided question; but a suit at law upon overdue coupons has been sustained,[9] although the mortgage securing them prescribed that, in case the coupons were not paid when due, the trustees at the request of one-fourth of the bondholders should enter into possession of the railroad, and sell it for the benefit of the creditors; "it being further expressly understood and agreed (any law or usuage to the contrary notwithstanding) that neither the whole nor any part of the property . . . shall be sold under proceedings either at law or in equity for the recovery . . . by the holder or holders of the bonds . . . of the whole or any portion of the principal or interest of the said bonds, it being the intention and agreement of the parties, for the better securing of the largest possible price, . . . that the method of sale hereinbefore provided shall be exclusive of all others."

In Pennsylvania the courts formerly had no general jurisdiction in equity, and therefore, until a recent statute[10] gave such jurisdiction in cases of corporation mortgages, there could be no decree for

[7] Jones Mortgages, § 177; Eaton &c. R. Co. v. Hunt, 20 Ind. 457; Williamson v. New Albany R. Co. 1 Biss. (U. S.) 198; Land Title &c. Co. v. Asphalt Co. 127 Fed. 1; Guardian &c. Co. v. White Cliffs &c. Co. 109 Fed. 523. But see Alabama &c. Co. v. Robinson, 56 Fed. 690.

[8] McAllister v. Plant, 54 Miss. 106; Dow v. Memphis &c. R. Co. 20 Fed. 260.

[9] Widener v. Railroad Co. 1 Wkly. Notes Cas. 472.

[10] April 11, 1862, 1 Brightly's Purdon's Dig. 593.

the sale of mortgaged property at the instance of the mortgagee.[11] A power of sale in such a mortgage might be executed according to the terms of the appointment: but the court could not direct the execution of it except at the suit of a party standing in the relation of *cestui que trust,* and for the purpose of administering the trust.[12] Now the Supreme Court may decree a sale under a railroad mortgage, and the act giving the court jurisdiction in such case applies to mortgages made before its passage, as it merely provides a new remedy for a breach of contract.[13] When the mortgage creates a trust, and provides that power of sale may be executed by the trustee on certain contingencies, the court may in equity control and regulate the exercise of the power at the suit of a *cestui que trust;* and when it has once decided that the contingency has arisen to give it jurisdiction, its decision cannot be impeached collaterally.[14]

§ 339a. **Though the trust deed gives a power of sale after advertisement only on request of seventy-five per cent. of the amount of bonds secured,** such remedy is cumulative merely. It was contended that the provision that upon the prescribed default in the payment of interest the principal of the bonds should become due is so far subject to the wishes of the majority of the bondholders that the trustee is without power to foreclose. As to the particular form of foreclosure and sale at public auction by advertisement, and without the aid of the court, the proper construction is that such action cannot be taken without the prescribed request. But this does not limit the power of the trustee to proceed by application to a court of equity to foreclose, it being provided in the trust deed that nothing therein contained should prevent foreclosure by any court of competent jurisdiction.[15]

§ 340. **Suit at law upon the bonds.**—The fact that a railroad mortgage empowers the trustees, upon the written request of the

[11] Ashhurst v. Montour &c. Co. 35 Pa. St. 30.

[12] Bradley v. Chester Valley R. Co. 36 Pa. St. 141.

[13] McElrath v. Pittsburgh &c. R. Co. 55 Pa. St. 189; McCurdy's Appeal, 65 Pa. St. 290.

[14] Youngman v. Elmira &c. R. Co. 65 Pa. St. 278.

[15] Morgan's Co. v. Texas Cent. R. Co. 137 U. S. 171; 11 Sup. Ct. 61.

holders of bonds to a specified amount, after breach of the condition, to sell the property, is no defense to a suit at law upon the bonds or coupons after they are payable. The bonds are the principal debt, and the mortgage is only an incidental security. The remedies at law and in equity do not clash and destroy each other, but exist together.[16]

A right of action accrues upon a bond upon the non-payment of the stipulated interest when due. It is immaterial whether the bond is secured by mortgage or not.[17]

The mortgage might positively, or perhaps impliedly, take away from the bondholder his right of action at law upon the bonds or coupons; but the common law right to enforce these obligations remains if not so taken away.[18]

The remedy upon the bonds by action at law may, however, be barred by the statute of limitations, while the remedy upon the mortgage is not barred by any lapse of time short of the period sufficient to raise the presumption of payment of the mortgage.[19]

Though a bondholder may recover a judgment at law on his bond, his remedy against the property conveyed to the trustee is only through him. His execution must be levied on property actually owned by the company and not upon that which has been conveyed to trustees by mortgage or deed of trust. He stands when suing at law and proceeding against the company on the same plane as any other creditor.[20] But it has been held also that a bondholder who has been a party to a purchase of the equity of redemption cannot sue at law and recover a judgment on his bonds. Having purchased the property subject to the lien, the bonds became a part of the purchase money withheld at the time of the sale; in other words they were a part of the bid.[21]

[16] Philadelphia &c. R. Co. v. Johnson, 54 Pa. St. 127. The action in this case was upon six bonds amounting together to $1,400; also see Welsh v. St. Paul &c. R. Co. 25 Minn. 314; Manning v. Norfolk &c. R. Co. 29 Fed. 838.

[17] Marlor v. Texas &c. R. Co. 19 Fed. 867.

[18] Manning v. Norfolk &c. R. Co. 29 Fed. 838.

[19] Smith v. Washington City &c. R. Co. 33 Gratt. (Va.) 617. See Jones Mortgages, §§ 915, 1204.

[20] Western Penn. Hospital v. Mercantile Library Hall Co. 189 Pa. St. 269; 42 Atl. 183.

[21] Cock v. Bailey, 146 Pa. St. 328; 23 Atl. 370.

In an action against a railroad company for the value of bonds which the company had agreed to deliver to plaintiff in part payment for property conveyed to the company, the bonds never having been delivered, the plaintiff is entitled to recover the par value of the bonds, though their value in the market is less.[22]

§ 340a. Right of action on bond taken away by provision in mortgage.—In regard to an action at law after foreclosure, it has been declared that railway bonds and mortgages securing their payment constitute a distinct and special class of securities. Where such a railway bond contains a clear statement that it is one of a series of bonds secured by a mortgage to a trustee upon the property of the railway, every proposed purchaser is thereby advised that, if he buys, he will be brought into contract relations with his co-bondholders, and that his absolute rights in respect to the foreclosure of the mortgage, or the collection thereby of the principal or interest of his bond, are limited by the provision of the trust deed and the peculiar nature of the security. A mere general reference to the mortgage in the bond is insufficient to advise the bondholder of a provision which is absolutely repugnant to the terms of the bond. It is not a fair construction to hold that such a reference is notice to the bondholder that his right to bring suit for the interest, when due, is qualified by something in the trust deed, as that is inconsistent with the absolute obligation which the bond imports on its face, and is not suggested by anything appearing on it.[23]

But a provision in a mortgage deed of trust for the trustee to obtain a deficiency judgment against the mortgagor after exhausting the security, precludes a bondholder from recovering a judgment at law upon his bond after foreclosure, even though the bondholder occupies the position of a *bona fide* purchaser. A covenant with the trustee for the personal liability of the mortgagor for the payment of the bonds, and for the enforcement of any deficit after the trustee has exhausted the security, cannot be given full effect by any other construction. The personal covenant is not inserted with a

[22] Texas &c. R. Co. v. Gentry, 69 Tex. 625; 8 S. W. 98.

[23] Guilford v. Minneapolis &c. R. Co. 48 Minn. 560; 51 N. W. 658; 31 Am. St. 694. Compare Siebert v. Minneapolis &c. R. Co. 52 Minn. 148; 53 N. W. 1134; 20 L. R. A. 535n; 38 Am. St. 530.

view to its enforcement by the several bondholders. If such were its object it would be wholly unnecessary, for without it they have such right, but the trustee has not. The provision necessarily confers the power to deal with the deficit upon the trustee. This avoids a multiplicity of suits and a disastrous race of diligence by the individual bondholders by substituting the inexpensive and just plan of extending the trusteeship to the deficit. The trustees' authority to take a personal judgment for the deficiency after exhausting the security excludes a bondholder from suing at law for the deficiency, and the reference to the mortgage contained in the bond puts the purchaser of bonds on inquiry in regard to such a provision in the mortgage.[24]

The remedy at suit of a trustee on request of a majority of bondholders has been held to be exclusive, even as to suit at law, and to preclude a bondholder from suing on his bonds.[25]

§ 341. Recovery of possession. A court of equity has jurisdiction to order a specific performance of a stipulation in a railroad mortgage, authorizing the trustees to take possession of the mortgaged property for the non-payment of the bonds secured, and a bill in equity is the proper form of proceeding to compel the company and its agents to deliver possession to the trustees.[26] When foreclosure is sought by a bill in equity, delivery of possession to the trustees or to a receiver is obtained by the same bill; and a separate bill for this purpose is necessary only when foreclosure is sought by some other method, such as a power of sale, or by entry and possession.

Liens are enforceable in equity only, unless the law has provided for another mode. This is true of vendors' liens, equitable and other mortgages, and all statutory liens, except in all cases where the lien is in the nature of a pledge, and possession accompanies the lien. A court of law does not possess the means of enforcing such liens.[27]

[24] Grant v. Winona &c. R. Co. 85 Minn. 422; 89 N. W. 60.

[25] Batchelder v. Council Grove &c. Co. 131 N. Y. 42; 29 N. E. 801.

[26] Shepley v. Atlantic &c. R. Co. 55 Me. 395; Shaw v. Norfolk County R. Co. 5 Gray (Mass.), 162; Sacramento &c. R. Co. v. San Francisco, 55 Cal. 453, quoting text; McLane v. Placerville &c. R. Co. 66 Cal. 606; American Bridge Co. v. Heidelbach, 94 U. S. 798; Dow v. Memphis &c. R. Co. 20 Fed. 260.

[27] Cairo &c. R. Co. v. Fackney, 78 Ill. 116.

§ 342. Possession must be taken of the whole property. A power in a mortgage, authorizing the mortgagee, upon default of payment, to take possession of the railroad and the property connected therewith, and use or sell the same, must be exercised upon all the property mortgaged as an entire thing; and it does not authorize the mortgagee to take possession of particular portions of the property, leaving the residue in the possession of the corporation. If this could be done, the road might be rendered useless to both creditors and stockholders; and, what is of greater importance, neither the mortgagee nor the corporation would be able to discharge the public obligation to use the road as a highway, for which the charter of the company was granted. Therefore the mortgagees of a railroad have no authority, before taking possession of the entire property, to replevy a portion of the mortgaged property from an officer who has levied an execution upon it.[28]

The mortgagee in such case stands upon no higher ground in respect to an officer who has legally levied an execution upon the property than the corporation itself. The mortgagee must either take possession of the whole property, or obtain an injunction against the sale and removal of the property levied upon. But when the mortgage debt exceeds the value of the property covered by the mortgage, the whole equitable interest in the property is in the mortgagee, and consequently a creditor acquires no substantial interest by a levy upon a portion of the property; and in such case, although the mortgagee has in vindication of his rights recovered in replevin the property levied upon, yet the creditor is entitled only to nominal damages.[29]

§ 343. The remedy at law for the recovery of possession is in most cases inadequate. It is said that the mortgage trustee may maintain an action at law in the nature of ejectment to recover possession, when he is entitled to such possession by the terms of the trust deed.[30]

But where the mortgage embraces, real, personal, and mixed prop-

[28] Coe v. Peacock, 14 Ohio St. 187.

[29] Coe v. Peacock, 14 Ohio St. 187.

[30] Rice v. St. Paul &c. R. Co. 21 Minn. 464.

erty, the appropriate remedy to recover possession is in equity. Ejectment does not lie for personal property, records, and choses in action. A railroad in its entirety consists of both real and personal property, and the roadbed, track, and stations are comparatively valueless without its rolling stock and personal property. The forms and processes of a court of law are not flexible enough to transfer the possession of the mortgaged property as a whole. An action at law against an insolvent mortgagor for damages for non-delivery of the property would be an inadequate remedy.[31]

§ 344. Upon default a mortgage trustee is entitled to possession as against a contractor in possession. Though a contractor is, under his contract for constructing a railroad, entitled to the possession of the road until his contract is completed, and he has received a large amount of mortgage bonds under his contract, yet his right to the possession of the road is subordinate to the right of the mortgage trustees to the possession upon a default in the payment of interest on the bonds before the completion of the road.[32]

§ 345. A threatened injury to mortgaged property may be restrained by injunction. Thus, the receivers of a railway appointed in a suit for the foreclosure of a mortgage upon it were allowed this relief against another railway company which threatened to lay their track on a part of the mortgaged premises, and thereby inflict a serious damage, without allowing compensation, although they claimed the right to do so by virtue of an agreement made with the mortgagors or their grantees. The agreement, however, was made subsequently to the mortgage, and therefore could not affect the rights of the mortgagees under it.[33]

The possession of mortgage bonds, and their production in the cause, is sufficient to give the holder a standing in court and entitle him to relief by injunction against the interference with the mort-

[31] Dow v. Memphis &c. R. Co. 20 Fed. 260; First Nat. Ins. Co. v. Salisbury, 130 Mass. 303; Warner v. Rising Fawn Iron Co. 3 Woods (U. S.), 514; North Car. R. Co. v. Drew, 3 Woods (U. S.), 692, 713.

[32] Allen v. Dallas &c. R. Co. 3 Woods (U. S.), 316.

[33] Coe v. New Jersey &c. R. Co. 28 N. J. Eq. 27.

gaged property by a judgment creditor. It is no valid objection that he has pledged some of the bonds to other persons as collateral security, for he has not thereby lost his title as owner. Being a bondholder entitled to priority over a judgment creditor, he is entitled, in the absence of any action by the mortgage trustees, to maintain for himself and all other bondholders a suit to restrain such judgment creditor from enforcing his execution.[34]

The owner of bonds secured by a lien upon the lands of a railroad company may bring a suit to enjoin another corporation from obtaining such lands by the wrongful use of the name of the corporation whose bonds he holds. It should first appear, however, that the company had refused to take proper measures to protect its corporate rights.[35]

A railroad company may be enjoined from executing under authority of an act of the legislature a lease of the road which contains provisions which injuriously affect the rights of holders of the debts secured by an existing mortgage.[36]

§ 346. **A general creditor of a corporation cannot obtain an injunction against its executing a mortgage** of its property. If the claim be a lien upon the property, in the form of an attachment, judgment, execution, or otherwise, this will not be affected by a subsequent mortgage; and if it be not a lien by reason that the company is a foreign corporation, and is beyond the jurisdiction of the court, the mortgage, if executed, will not obstruct or prejudice the creditor's rights, because he has in such case no ground of preference over other creditors, either as a judgment or attaching creditor, or upon the ground of the insolvency of the corporation. Even if the court had jurisdiction of the property without such lien, it would be authorized to interfere by injunction only in an action by all the creditors, or for the benefit of all the creditors.[37]

§ 346a. **Mortgagees may maintain a suit for an injunction to prevent acts tending to disperse the property.** They have no ad-

[34] Butler v. Rahm, 46 Md. 541.

[35] Newby v. Oregon &c. R. Co. 1 Sawyer (U. S.), 63.

[36] Phillips v. Eastern R. Co. 138 Mass. 122.

[37] Rogers v. Michigan &c. R. Co. 28 Barb. (N. Y.) 539.

equate remedy at law before default. If they are not entitled to immediate possession of the property, but only to have it kept together, they cannot maintain replevin against a levying creditor. To put them to an action for damages would be requiring them to accept, to the extent of the damages, payment of the mortgage before it is due. Therefore a mortgagee may always by injunction restrain any wrongful acts, the effect of which will be to impair his security. An injunction requiring the levying creditor to allow the company to retake the property levied on is in effect a mandatory injunction, requiring defendants to do an affirmative act. That courts of equity may issue injunctions in effect mandatory is well settled.[38]

§ 347. **A railroad company has no right as against its mortgagee to take up any part of the mortgaged road,** and it may be enjoined from doing so, although that portion of the road which it is taking up is not self-sustaining, but an expense to the company; or although it would be an injury and loss to the company to permit the rails to remain on the street and be destroyed: or although the mortgagee has ample security left for the bonds he claims, and the company is willing to appropriate the proceeds of the sale of the rails taken up in liquidation of the mortgage. The company, by giving the mortgage, has parted with the right to decide the question of the expediency of giving up a part of its road. It has no right to touch the road except in the ordinary use and proper repair of it. The mortgagee has the right to hold all the property mortgaged until he is fully satisfied. His rights cannot be preserved if the mortgagor has the right to destroy the security by inches. Full effect can be given to the contract of the parties only by preserving the whole property intact.[39]

§ 348. **A state cannot be sued except** in cases where it has authorized the bringing of suits against it. But the mere fact that a state officer, whatever may be his grade, is a party, does not necessarily defeat the jurisdiction of the court, although the state may be the real party in interest, and cannot as such be brought before

[38] Central &c. Co. v. Moran, 56 Minn. 188; 57 N. W. 471; 29 L. R. A. 212.

[39] Watt v. Hestonville &c. R. Co. 1 Brew. (Pa.) 418; 6 Phila. 386.

the court. Thus, when the governor and attorney general of a state, under the authority of an act of the legislature, proceed to sell a railroad and its franchises in satisfaction of a statutory lien claimed in behalf of the state, these officers do not act in their political or executive capacity, but simply as agents, in obedience to the power committed to them by the legislative act, which might have conferred the same power upon any other person as well.[40]

§ 349. A state, by owning the majority of the stock of a railroad company and pledging its stock to secure second mortgage bondholders, does not become a trustee for such bondholders in the management of the company. Therefore, if the directors of the company, a majority of whom were appointed by the state, make a lease of the company's property under statutory authority to another railroad company at a rental sufficient only to pay the interest on the first mortgage bonds, the second mortgage bondholders cannot maintain a bill against the lessee to compel it to account for the excess of earnings above the amount of interest on the first mortgage bonds, upon the theory that the state impliedly became a trustee for them, and that the earnings of the road became a trust fund which complainants could follow in the hands of the lessee, which became such with notice. The state was no more a trustee than any other majority shareholder of the corporation.[41]

II. *Jurisdiction of State and Federal Courts of Suits against Corporations.*

§ 350. A corporation is not amenable to process except in the state in which it is established, and in which its corporate functions are exercised. It has no legal existence in any other state.[42]

[40] Murdock v. Woodson, 2 Dill. (U. S.) 188. See Missouri v. McKay, 43 Mo. 594, 599.

[41] Gibson v. Richmond &c. R. Co. 37 Fed. 743.

[42] Bank of Augusta v. Earle, 13 Peters (U. S.), 519, 588; Marshall v. Baltimore &c. R. Co. 16 How. (U. S.) 314, 328; Lafayette Ins. Co. v. French, 18 How. (U. S.) 404; Ohio &c. R. Co. v. Wheeler, 1 Black (U. S.), 286, 297; Lathrop v. Union Pacific R. Co. 1 MacArthur (D. C.), 234; Farnum v. Blackstone &c.

This rule applies not only to state courts, but also to the United States courts. The Circuit Court of the United States, sitting in a state, has no jurisdiction beyond the limits of the state, except in criminal cases. Subpœnas may be issued for witnesses throughout the United States. In every other particular, the federal court acting in a state is as limited in its jurisdiction as any state court whose jurisdiction extends throughout the state.[43]

The service of process upon the treasurer or other officer of a foreign corporation, although the corporation has an office and place of business within the state, does not give the courts jurisdiction. An attachment of the property of a foreign corporation would, in Massachusetts and some other states, have this effect; jurisdiction may also be given by express statute;[44] and accordingly in several states suits against foreign corporations having agents within the state, conducting the general business for which the corporations were organized, may be commenced by service of process upon such agents. But generally a corporation which does not exercise its corporate franchises in a foreign state, and which has no business agency established there, cannot be sued in its courts.[45]

Jurisdiction of a suit against a non-resident corporation cannot

Corp. 1 Sumner (U. S.), 46; Cleveland &c. R. Co. v. Speer, 56 Pa. St. 325; 94 Am. Dec. 84.

[43] Northern Ind. R. Co. v. Michigan Cent. R. Co. 5 McLean (U. S.), 444. Acts of Congress of March 3, 1887, and August 13, 1888, require an action in the federal courts to be brought in the district of which the defendant is a resident. Accordingly a federal court in Illinois cannot obtain jurisdiction of an Iowa corporation by service of process. Jessup v. Ill. Cent. R. Co. 36 Fed. 735. The Circuit Court of the United States sitting in a district in Louisiana has no jurisdiction to appoint a receiver with power to take possession of a railway situated in Texas, and to control and operate it under its orders, even though the railway is chartered by Congress. The intention of Congress to limit the jurisdiction of Circuit Courts to persons and things within the district in which the court sits is manifested by several statutes. A court cannot confer upon a receiver power outside the territory over which it has jurisdiction, for its processes cannot be effective beyond that. Hence such a receiver would be a mere agent and the railroad would be liable for his acts in managing the property. Texas &c. R. Co. v. Gay, 86 Tex. 571; 26 S. W. 11; 25 L. R. A. 52.

[44] Andrews v. Michigan &c. R. Co. 99 Mass. 534; 97 Am. Dec. 51.

[45] Lathrop v. Union Pacific R. Co. 1 MacArthur (D. C.), 234.

be taken upon the ground that the defendant corporation has property within the state, when that property is only the unissued bonds of the company in the hands of its agents for sale. Such bonds are not property within the legal signification of the term.[46]

§ 351. A corporation is foreign to any state only when it owes its corporate existence in no part to the legislation of that state. A corporation is domestic in any state in which corporate powers and franchises have been conferred upon it, or upon an original corporation which has been united in the new one by consolidation. It may have a corporate entity in each of two or more states, and be both foreign and domestic in each. In a suit by or against such consolidated corporation, it must be treated as domestic in each of the states under whose laws it is established as a corporation.[47] But a railroad company incorporated under the laws of one state, and operating its road in another state by the assent or license of the legislature of the latter, is liable to process only in the former state as a domestic corporation.[48] A foreign corporation, upon which the legislature of another state has conferred the power to purchase and hold lands in that state, does not by reason of such legislation acquire a domestic character. It can properly be said to exist only in the state that created it.[49] If a railroad corporation existing in one state is authorized by the laws of another state to extend its road into the latter, it does not thereby become a corporation and citizen of the latter state.[50]

[46] Barnes v. Mobile &c. R. Co. 12 Hun (N. Y.), 126; 5 N. Y. Wkly. Dig. 191; Coddington v. Gilbert, 17 N. Y. 489.

[47] Sprague v. Hartford &c. R. Co. 5 R. I. 233; McGregor v. Erie R. Co. 35 N. J. L. 115; Maryland v. Northern Central R. Co. 18 Md. 193; Ohio &c. R. Co. v. Wheeler, 1 Black (U. S.), 286; People v. Lake Shore &c. R. Co. 11 Hun (N. Y.), 1; Graham v. Boston &c. R. Co. 118 U. S. 161; 6 Sup. Ct. 1009; 25 Am. & Eng. R. Cas. 53; State v. Chicago &c. R. Co. 25 Neb. 156; 41 N. W. 125; 2 L. R. A. 564n; Stone v. Farmers' &c. Co. 116 U. S. 307; 6 Sup. Ct. 334, 388, 1191; Booth v. St. Louis &c. Mfg. Co. 40 Fed. 1.

[48] Goodlett v. Louisville &c. R. Co. 122 U. S. 391; 7 Sup. Ct. 1254; 33 Am. & Eng. R. Cas. 1. See, however, Pennsylvania R. Co. v. Peoples, 31 Ohio St. 537; 6 Cent. L. J. 436.

[49] New Jersey v. Delaware &c. R. Co. 30 N. J. L. 473.

[50] Penn. R. Co. v. St. Louis &c. R. Co. 118 U. S. 290; 6 Sup. Ct. 1094; Goodlett v. Louisville &c. R

An averment that a company is a corporation under and by the laws of a certain state is a sufficient averment that it is a citizen of that state.[51]

§ 352. A corporation already existing in one state may be invested with corporate rights and privileges by the legislature of another state, and thereby derive a separate existence in the latter state. The fact that the corporation has the same name in both states does not change the fact that it is a distinct corporation in each.[52]

It is competent also to provide by legislation that a foreign corporation, having an agency in a state for the transaction of business, or making contracts there, may be held to answer suits in such state commenced by the service of process upon the president, secretary, treasurer, or other agent of the corporation within the state. Thus a railroad company incorporated in Virginia borrowed money in New York through the agency of its treasurer, and an action was commenced, in accordance with a statute, against the company in a court of the latter state, by service of process upon its secretary, who

Co. 122 U. S. 391; 7 Sup. Ct. 1254; 33 Am. & Eng. Cas. 1.

[51] Keep v. Mich. &c. R. Co. 6 Chicago L. News, 101.

[52] Goodlett v. Louisville &c. R. Co. 122 U. S. 391; 7 Sup. Ct. 1254; 33 Am. & Eng. R. R. Cas. 1; Rece v. Newport News &c. Co. 32 W. Va. 164; 9 S. E. 212; 3 L. R. A. 572; 5 Rail. & Corp. L. J. 515; Railroad Co. v. Vance, 96 U. S 450: Memphis &c. R. Co. v. Alabama, 107 U. S. 581; 2 Sup. Ct. 432; 13 Am. & Eng. R. R. Cas. 172; Atwood v. Shenandoah &c. R. Co. 85 Va. 966; 9 S. E. 748; Pennsylvania R. Co. v. St. Louis &c. R. Co. 118 U. S. 290, 296; 6 Sup. Ct. 1094; 24 Am. & Eng. R. Cas. 58.

In this case, Miller, J., for the court, said: "It may not be easy in all such cases to distinguish between the purpose to create a new corporation, which shall owe its existence to the law or statute under consideration, and the intent to enable the corporation already in existence, under laws of another state, to exercise its functions in the state where it is so received. To make such a company a corporation of another state, the language used must imply creation or adoption in such form as to confer the power usually exercised over corporations by the state, or by the legislature, and such allegiance as a state corporation owes to its creator. The mere grant of privileges or powers to it as an existing corporation, without more, does not do this, and does not make it a citizen of the state conferring such powers."

was found in the state, and judgment rendered. Upon a transcript of this judgment suit was brought against the corporation in the District of Columbia, where it had an office; and it was held that, the corporation having contracted the debt in New York, its court obtained complete jurisdiction by the service made in the suit, and that the judgment was entitled to the same conclusiveness elsewhere that it had in the state where it was rendered.[53]

§ 353. A state cannot, however, by mere legislative declaration, make all foreign corporations domestic corporations of such state; at least, it cannot, by such declarations, deprive foreign corporations of their right to resort to the federal courts, in cases where such right is conferred by the Constitution and laws of the United States. A statute of the state of West Virginia, declaring that in all suits foreign railroad corporations doing business in that state shall be treated as domestic corporations, and shall file an agreement to that effect, is, so far as it attempts to deprive such corporations of the right to remove to the federal courts suits brought by or against such corporations in cases in which they would otherwise be entitled to such right, inoperative and void; and such foreign corporations may exercise such right in any proper case, notwithstanding it has executed and filed such agreement in pursuance of the provisions of such statute.[54]

§ 354. For the purpose of federal jurisdiction, a corporation is conclusively considered to be a citizen of the state which created it.[55] In the case of a company organized under the laws of one state, and afterwards extending its line of road into another state, under whose laws the company is licensed to act, but is not re-incorporated, the company remains a citizen of the state in which it was originally

[53] Weymouth v. Washington &c. R. Co. 1 MacArthur (D. C.), 19.

[54] Rece v. Newport News &c. Co. 32 W. Va. 164; 9 S. E. 212; 3 L. R. A. 572n; 5 Railw. & Corp. L. J. 515. See, also, Railroad Co. v. Koontz, 104 U. S. 5; Ohio &c. R. Co. v. Wheeler, 1 Black (U. S.), 286; Muller v. Dows, 94 U. S. 444; Memphis &c. R. Co. v. Alabama, 107 U. S. 581; 2 Sup. Ct. 432.

[55] Insurance Co. v. Francis, 11 Wall. (U. S.) 210; Pacific R. v. Missouri &c. R. Co. 23 Fed. 565; Schollenberger, Ex parte, 96 U. S. 369, 377; Railroad Co. v. Koontz, 104 U. S. 5.

organized.[56] Without the sanction of the legislature, a domestic corporation has no power to sell out to another company all or a part of its road and franchise; and a foreign company without such sanction would have no authority to purchase or operate the road of a domestic corporation. Legislation of a state designed to encourage the building of railroads and to facilitate the making of continuous or connected lines, by authorizing, so far as possible, its own companies to extend their roads into other states, and by conferring upon the companies of other states the right to lease or to buy, and to build and operate, roads within its limits, does not ordinarily constitute new corporations of such foreign corporations as may take the benefit of such legislation, but simply gives them, on the conditions stated, certain specified rights, powers, and immunities.[57]

This doctrine of the citizenship of corporations is based upon the presumption, which cannot be contradicted, that the individual members of a corporation having a legal existence in a state are citizens of that state.[58] Prior to 1844, it was held necessary to aver that the corporators were citizens of the state; but the Supreme Court of the United States then reexamined the subject of the jurisdiction of the federal courts, and held that a corporation created by the laws of a state, and having its place of business within that state, must, for the purpose of suit, be regarded as a citizen within the meaning of the Constitution giving jurisdiction founded upon citizenship.[59] It is now the settled construction that an allegation, that a defendant corporation was incorporated by a state other than that of which the plaintiff is a citizen, is a sufficient averment of jurisdiction.

The stockholders of a corporation are conclusively presumed to

[56] Muller v. Dows, 94 U. S. 444; Railroad Co. v. Harris, 12 Wall. (U. S.) 65; Railway Co. v. Whitton, 13 Wall. (U. S.) 270, 285; Louisville &c. R. Co. v. Letson, 2 How. (U. S.) 497; Marshall v. Baltimore &c. R. Co. 16 How. (U. S.) 314; New York &c. R. Co. v. Shepard, 5 McLean (U. S.), 455; McElrath v. Pittsburgh &c. R. Co. 55 Pa. St. 189; Goodlett v. Louisville &c. R. Co. 122 U. S. 391; 7 Sup. Ct. 1254; 33 Am. & Eng. R. Cas. 1.

[57] Williams v. Missouri &c. R. Co. 3 Dill. (U. S.) 267, where Judge Dillon states the law and examines the authorities.

[58] Ohio &c. R. Co. v. Wheeler, 1 Black (U. S.), 286; National Park Bank v. Nichols, 4 Biss. (U. S.) 315; Hatch v. Chicago &c. R. Co. 6 Blatchf. (U. S.) 105; Hobbs v. Manhattan &c. Co. 56 Me. 417; 96 Am. Dec. 472.

[59] Louisville &c. R. Co. v. Letson, 2 How. (U. S.) 497.

be citizens of the state which created it, for the purposes of a suit by or against it in a court of the United States. A corporation itself is not a citizen, and therefore the bill should allege the fact of incorporation, and incorporation by a state whereof the adverse party is not a citizen; but a defective averment of citizenship may be cured by subsequent pleadings.[60]

The pendency of a foreclosure suit in the court of a state is no bar to a suit in the Circuit Court of the United States between the same parties for the foreclosure of the same mortgage, if the latter court has jurisdiction.[61]

§ 355. A corporation created by the laws of two states may be sued by a citizen of one of these states in the federal court for the other state; for by the laws of the latter state the defendant is a citizen of that state, whatever its status or citizenship may be elsewhere.[62] But a citizen of one of these states cannot sue such corporation in the Circuit Court of the United States for his own state, for in that state the corporation is not a citizen of another state.[63]

The rule may be stated more broadly, that where a corporation created by the laws of several states is sued in a federal court in any one of those states, it must be regarded, for the purpose of jurisdiction, as a citizen of that state, whatever its citizenship may be elsewhere.[64]

A federal court has jurisdiction of a suit by a bondholder, or the owner of coupons, against a foreign railroad company to compel an accounting, though the mortgage trustee, a citizen of the same state as the plaintiff, is joined as a defendant, because the trustee had refused to bring the suit when requested so to do.[65]

[60] Muller v. Dows, 94 U. S. 444; Lafayette &c. Co. v. French, 18 How. (U. S.) 404.

[61] Stanton v. Embrey, 93 U. S. 548; Insurance Co. v. Brune, 96 U. S. 588; Weaver v. Field, 16 Fed. 22; Beekman v. Hudson &c. R. Co. 35 Fed. 3.

[62] Railway Co. v. Whitton, 13 Wall. (U. S.) 270, 283; Page v. Fall River &c. R. Co. 31 Fed. 257.

[63] Burger v. Grand Rapids &c. R. Co. 22 Fed. 561; Uphoff v. Chicago &c. R. Co. 5 Fed. 545; Nashua &c R. Co. v. Boston &c. R. Co. 8 Fed. 458; 19 Fed. 804.

[64] Muller v. Dows, 94 U. S. 444; Union Trust Co. v. Rochester &c. R. Co. 29 Fed. 609.

[65] Barry v. Missouri &c. R. Co. 27 Fed. 1.

§ 356. The federal courts have jurisdiction of suits against counties and municipalities under the same conditions that they have jurisdiction of private corporations. It has been objected as regards counties that they are only *quasi* corporations, and really only subordinate political divisions of a state, and not citizens within the meaning of the Constitution or acts of Congress.[66] "Though the metaphysical entity called a corporation may not be physically a citizen, yet the law is well settled that it may sue and be sued in the courts of the United States, because it is but the name under which a number of persons, corporators and citizens, may sue and be sued. In deciding the question of jurisdiction, the courts look behind the name to find who are the real parties in interest. In this case the parties to be bound by the judgment are the people of Washington County. That the defendant is a municipal corporation, and not a private one, only furnishes a stronger reason why a citizen of another state should have his remedy in this court, and not in a county where the parties against whom the remedy is sought would compose the court and jury to decide their own case."[67]

§ 357. The federal courts have no jurisdiction of actions between states and their own corporations; but that jurisdiction extends "to all controversies between a state and the citizens of another state."[68] In a suit by the Commonwealth of Pennsylvania against a corporation, an averment that the defendant is a "body politic in the law of, and doing business in, the State of California," was held to be insufficient to establish the jurisdiction of the courts of the United States because it did not necessarily import that the corporation was not created by the laws of the State of Pennsylvania.[69]

Inasmuch as the Judiciary Act[70] provides that the United States Circuit Court shall have jurisdiction only of suits between a citizen of the state in which the suit is brought and a citizen of another state,

[66] McCoy v. Washington County, 3 Phila. 290; 7 Am. L. 193; Lyell v. Lapeer County, 6 McLean (U. S.), 446; Cowles v. Mercer County, 7 Wall. (U. S.) 118; McPike v. Lincoln County of Mo. 7 Cent. L. J. 264.

[67] Mr. Justice Grier, in McCoy v. Washington County, 3 Phila. (Pa.) 290; 7 Am. Law Reg. 193.

[68] By Article xi. of amendments to the Constitution, a state cannot be sued by citizens of another state.

[69] Pennsylvania v. Quicksilver Co. 10 Wall. (U. S.) 553.

[70] Judiciary Act of 1789.

and that suit shall be brought in the district in which the defendant is an inhabitant, or in which he shall be found at the time of serving the writ, if a corporation or person necessary to the litigation, but not belonging to such district, be joined as defendant with other defendants belonging to such district, the court has no jurisdiction of such non-resident party. But in a suit to foreclose a mortgage given by a corporation, the bondholders are not necessary parties; and if some of them are joined as defendants, it is not necessary that their citizenship should appear to be such as to entitle them to be parties.[71]

A corporation which has a legal existence in any one state can sue in the federal courts within any other state.[72]

§ 358. Where a railroad company which maintains a continuous line of road through several states holds charters from each of the states in which any part of its road is located, it is, for the purpose of giving jurisdiction to the courts of the United States, a citizen of each of the states under whose laws it exists.[73] Thus, the Philadelphia, Wilmington and Baltimore Railroad Company, owning a line of road from Philadelphia to Baltimore, running through parts of the States of Pennsylvania, Delaware and Maryland, and incorporated in each, is a corporation of each of these states, and a citizen of each, within the meaning of the Judiciary Act. The fact that only a small portion of its road is in the State of Delaware does not prevent its being sued in that district.[74]

[71] Keep v. Michigan &c. R. Co. 6 Chicago Legal News 101; and see Hervey v. Illinois &c. R. Co. 7 Biss. (U. S.) 103, as to merely nominal parties having no actual interest.

[72] National Park Bank v. Nichols, 4 Biss. (U. S.) 315; Manufacturers' National Bank v. Baack, 8 Blatchf. (U. S.) 137.

[73] Pacific R. Co. v. Missouri R. Co. 23 Fed. 565.

[74] Minot v. Philadelphia &c. R. Co. 2 Abbott (U. S.), 323; Goodlett v. Louisville &c. R. Co. 122 U. S. 391; 7 Sup. Ct. 1254; Ohio &c. R. Co. v. Wheeler, 1 Black (U. S.), 286, 297; Railroad Co. v. Vance, 96 U. S. 450; Memphis &c. R. Co. v. Alabama, 107 U. S. 581; 2 Sup. Ct. 432.

With reference to the Ohio and Mississippi Railroad Company, Taney, C. J., said: "It is true that a corporation by the name and style of the plaintiff's appears to have been chartered by the States of Indiana and Ohio, clothed with the same capacities and powers, and intended to accomplish the same objects, and it is spoken of in the laws of the states as one corporate

The constitutional right which a corporation has as a citizen of one state to sue the citizens of another state in the federal courts cannot be taken away by legislative declaration that such corporation is a corporation of the latter state.

§ 359. **When two or more states have by concurrent legislation united in creating one and the same railroad corporation,** as they may do, a court in either state may exercise jurisdiction over the entire line.[76] By executing a mortgage as one body corporate of the entire line of road and property, the corporation would be estopped in a suit upon such mortgage from setting up its separate existence under the charters it has secured from the different states.[77] Moreover, if in a suit to foreclose such a mortgage the corporation be served with process in the state in which the suit is brought, and it enters its appearance and answers the bill by its common name, the court has jurisdiction by means of such appearance of the separate corporations which have joined under such common name, if it be conceded that the corporations are separate and distinct;[78] for a corporation may waive its right to be sued only in the state in which it is found or resides, and enter its appearance in any other jurisdiction it pleases.[79]

body, exercising the same powers and fulfilling the same duties in both states. Yet it has no legal existence in either state except by the law of the state, and neither state could confer on it a corporate existence in the other, nor add to or diminish the powers to be there exercised. It may, indeed, be composed of and represent under the corporate name the same natural persons. But the legal entity or person which exists by force of law can have no existence beyond the limits of the state or sovereignty which brings it into life, or endues it with its faculties and powers. The Ohio and Mississippi Railroad Company is therefore a distinct and separate corporate body in Indiana from the corporate body of the same name in Ohio." Ohio &c. R. Co. v. Wheeler, 1 Black (U. S.), 286, 297.

[75] Rece v. Newport News &c. Co. 32 W. Va. 164; 5 R. & Corp. L. J. 515.

[76] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409; 2 Woods (U. S.), 447, 454; Ellis v. Boston &c. R. Co. 107 Mass. 1; Randolph v. Wilmington &c. R. Co. 11 Phila. (Pa.) 502.

[77] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 447, 454.

[78] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 447, 454.

[79] Northern Indiana R. Co. v. Michigan Central R. Co. 15 How. (U. S.) 233, 242.

Where a railroad company owning a railroad lying in two different states, and chartered by each of these states, mortgages the whole road and franchise, whether there are two distinct corporations or one only, under these charters there is but one mortgage, and that embraces the whole road; and therefore, if the right of redemption in one state be sold on execution, the purchaser is entitled to redeem the whole road from the mortgage. He cannot redeem the part lying in one state alone, if he would; for the mortgagees have a lien upon every part of the road to secure every part of the debt.[80]

§ 360. When a mortgage executed by a railroad corporation organized under the laws of two or more states, covering its entire road and franchises, is foreclosed by suit in a court having jurisdiction in one state only, but having jurisdiction of the mortgagor and of the mortgage trustees, a valid decree of sale of the entire mortgaged property may be made, although a part of the property be situated beyond the court's jurisdiction.[81] While the court cannot send its process beyond its own state, and cannot deliver possession of land in another jurisdiction, it may command and enforce a transfer by process against the defendant. It may, moreover, in a proper case, effect the transfer by the agency of the trustees when they are complainants, by decreeing that they shall sell and convey all the mortgaged property in the several states.[82]

It is true that independent suits may be prosecuted for the foreclosure of a railroad mortgage in each of the several states in which a line of railroad exists; and in such case one suit may be regarded

[80] Wood v. Goodwin, 49 Me. 260; 77 Am. Dec. 259.

[81] Muller v. Dows, 94 U. S. 444. This was a suit brought in the Circuit Court of the United States at Des Moines, Iowa, to foreclose a mortgage on a line of road running into the State of Missouri. The mortgage was foreclosed, and the entire line, including the portion in Missouri, was sold, without any ancillary or other proceedings having been taken in Missouri. The decree required the mortgage trustees and the corporation to execute conveyances to the purchaser. This was done, and the title was thus made perfect. The Supreme Court of the United States sustained the decree and sale. Accord Woodbury v. Allegheny &c. R. Co. 72 Fed. 371. See, in connection with this case, Atkins v. Wabash &c. R. Co. 29 Fed. 161.

[82] McElrath v. Pittsburgh &c. R. Co. 55 Pa. St. 189; Muller v. Dows, 94 U. S. 444.

as the principal action, and the others merely as auxiliary or subsidiary; or each suit may be prosecuted with the intention of affecting the property within the limits of the state where it is brought. In the latter case the proceedings in the different courts should be uniform, if, as generally would be the case, the interests and the end to be attained are the same, and the sale of the property as a whole is desired.[83]

The decision of a state court as to the validity of a foreclosure of a railroad mortgage made in conformity to the state law, in a court of the state, is a rule of decision for the federal courts in the same matter.[84]

III. *Effect of Consolidation of Railroad Corporations upon the Jurisdiction of Suits against Them.*

§ 361. When two or more corporations organized under the laws of the same state are consolidated, the old corporations are extinguished and their powers merged in the new.[85] The consolidated corporation, for the purpose of answering for the liabilities of the old corporations, is deemed the same as each of its constituents, and may be sued under its new name for their debts as if no change had been made in the name or organization of the original corporation.[86]

[83] United States Rolling Stock Co. In re, 55 How. Pr. (N. Y.) 286; 57 How. Pr. (N. Y.) 16; Taylor v. Atlantic &c. R. Co. 57 How. Pr. (N. Y.) 9; 57 How. Pr. (N. Y.) 26.

[84] Sullivan v. Portland &c. R. Co. 94 U. S. 806; 4 Cliff. (U. S.) 212.

[85] Mead v. New York &c. R. Co. 45 Conn. 199; Cooper v. Corbin, 105 Ill. 224; Union Trust Co. v. Rochester &c. R. Co. 29 Fed. 609; Chesapeake &c. R. Co. v. Griest, 85 Ky. 619; 4 S. W. 323; 30 Am. & Eng. R. Cas. 149; Railroad Co. v. Georgia, 98 U. S. 359; St. Louis &c. R. Co. v. Berry, 113 U. S. 465; 5 Sup. Ct. 529; Graham v. Boston &c. R. Co. 118 U. S. 161; 6 Sup. Ct. 1009; 25 Am. & Eng. R. Cas. 53; Ridgway Township v. Griswold, 1 McCrary (U. S.), 151.

[86] Meyer v. Johnston, 53 Ala. 237; 15 Am. Railw. R. 467; affirmed, 64 Ala. 603; Indianapolis &c. R. Co. v. Jones, 29 Ind. 465; 95 Am. Dec. 654; McMahan v. Morrison, 16 Ind. 172; 79 Am. Dec. 418n. See Platt v. New York &c. R. Co. 26 Conn. 544; Zimmer v. State, 30 Ark. 677; Lauman v. Lebanon &c. R. Co. 30 Pa. St. 42; 72 Am. Dec. 685; People v. Louisville &c. R. Co. 120 Ill. 48; 10 N. E. 657; State v. Rail-

A consolidation does not, however, necessarily import that all the companies consolidated are dissolved and merged into one new company; for the term is equally applicable to a union of two or more companies in such a way that one of them is continued in existence, with enlarged powers, while the others are merged in and absorbed by it. The character of the consolidation is determined by the agreement of the companies and the statute authorizing the consolidation.[87] A consolidation and not a purchase is effected by a transfer of franchise and property to another corporation under an agreement to exchange stock in the old company for stock in the new.[88]

When the original corporations were incorporated by the laws of different states, and by concurrent legislation of these states these corporations are consolidated into one company, different views have been entertained, not only as to the result of the consolidation upon the original companies, but as to the effect of it upon the new. Upon the one hand it is claimed that the consolidated company is one corporation, while upon the other it is claimed that this is in fact two corporations having the same name, the same officers and stockholders, and a unity of interest. Under the one view, the old corporations no longer exist; while under the other view, they still exist as separate entities, but having the same name. As a practical matter, it is generally of no consequence which view is taken. A suit by or against the consolidated company is well brought, whether it be one corporation or two, for the necessary party is in either case before the court.[89]

Two or more states through which a railroad runs may, by concurrent legislation, unite in creating the same body corporate.[90] The Supreme Court of the United States has declared that there is no reason why several states cannot, by competent legislation, unite in creating the same corporation, or in combining several preexisting

way Co. 99 Mo. 30; 12 S. W. 290; 6 L. R. A. 222n; Evans v. Interstate &c. R. Co. 106 Mo. 594; 17 S. W. 489; Langhorn v. Richmond R. Co. 91 Va. 369; 19 S. E. 122; Chicago &c. R. Co. v. Ferguson, 106 Ill. App. 356.

[87] Meyer v. Johnson, 64 Ala. 603.

[88] Chicago &c. R. Co. v. Ferguson, 106 Ill. App. 356.

[89] Paine v. Lake Erie &c. R. Co. 31 Ind. 283.

[90] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409; 2 Woods, 447, 454.

corporations into a single one.[91] The effect of the consolidation of several corporations may be to dissolve the old corporations, and at the same instant to create a new one with the property and stockholders of those passing out of existence.[92] But the dissolution of the old corporations does not necessarily follow from their consolidation.[93] Whether such is the result of their union is a question to be determined by the intent of the legislature authorizing the consolidation, and that of the parties uniting in it, as well as by considerations of necessity arising from the rights and liabilities of the old corporations which may be still outstanding after the union.

It follows, therefore, that when a consolidated corporation created in several states is sued, and judgment is obtained against it in one of those states, the judgment is binding upon the corporation in all those states; and if the judgment is sued in another of those states, the case is not open to any inquiry upon its merits.[94]

§ 362. **Whether a consolidation of railroad companies works a dissolution of the old companies** and the creation of a new company has sometimes been regarded as depending almost wholly upon the legislative intent manifested in the statute under which the consolidation takes place.[95] If the amalgamation be full and complete, the effect may be to work a dissolution of the old company and the creation of a new company.[96] If the statute contains no grant of cor-

[91] Railroad Co. v. Harris, 12 Wall. (U. S.) 65, 82; and see Philadelphia &c. R. Co. v. Maryland, 10 How. (U. S.) 376; Delaware Railroad Tax, In re, 18 Wall. (U. S.) 206; Louisville &c. Co. v. Louisville &c. R. Co. 75 Fed. 433; Railroad Co. v. Roberson, 61 Fed. 592; 9 C. C. A. 646.

[92] Shields v. Ohio, 95 U. S. 319; Ohio &c. R. Co. v. People, 123 Ill. 467; 14 N. E. 874.

[93] Ohio &c. R. Co. v. The People, 123 Ill. 467; 14 N. E. 874; Compton v. Railway Co. 45 Ohio St. 592; 16 N. E. 110; 18 N. E. 468.

[94] Union &c. Co. v. Rochester &c. R. Co. 29 Fed. 609; Graham v. Boston &c. R. Co. 118 U. S. 161; 6 Sup. Ct. 1009; Texas &c. R. Co. v. M'Alister, 12 Am. & Eng. R. Cas. 289; Nashua &c. R. Co. v. Boston & L. R. 16 Am. & Eng. R. Cas. 488.

[95] Central R. &c. Co. v. Georgia, 92 U. S. 665; Pingree v. Michigan Central R. Co. 118 Mich. 314; 76 N. W. 635; 53 L. R. A. 274.

[96] Louisville &c. R. Co. v. Boney, 117 Ind. 501; 20 N. E. 432; 3 L. R. A. 435n; St. Louis &c. R. Co. v. Berry, 113 U. S. 465; 5 Sup. Ct. 529; Pennsylvania College Cases, 13 Wall. (U. S.) 190; Kansas &c. R. Co. v. Smith, 40 Kans. 192; 19 Pac.

porate powers to the consolidated company, it is difficult to see how a new corporation is created. A grant of corporate existence is never implied.[97] The fact that a consolidated company is liable for the debts of the old companies, or that it possesses the rights of the old companies, does not necessarily imply a surrender of the old charters.

The old companies are liable to actions by holders of their bonds, where the act of consolidation provides that they shall be deemed to continue in existence to preserve the rights of creditors; and they are not relieved from such liability by reason of the fact that all the property of the old companies has passed under the consolidation into the possession of the new company.[98] The consolidation company may execute a mortgage upon the consolidated property which will be paramount to the unsecured indebtedness of the constituent companies.[99]

Where part of the consideration for the transfer of the property of one of the companies to the consolidated company was the payment by the latter of certain unsecured bonds of the former, which bonds the consolidated company agreed to protect, the holders of the bonds acquire an equitable lien on the property of the consolidated company for the payment of their bonds.[100]

A grant of all the franchises, immunities, and exemptions of existing companies to a consolidated company does not confer upon the

636; State v. Nemaha Co. 10 Kans. 569, 578; Charity Hospital v. Gas Light Co. 40 La. Ann. 382; 4 So. 433.

[97] Per Strong, J., in Central R. &c. Co. v. Georgia, 92 U. S. 665; declaring that assertions to the contrary in McMahan v. Morrison, 16 Ind. 172; 79 Am. Dec. 418n; Clearwater v. Meredith, 1 Wall. (U. S.) 25, 40, were not necessary to the decisions made.

[98] Gale v. Troy &c. R. Co. 51 Hun (N. Y.), 470; 4 N. Y. S. 295; Compton v. Wabash &c. R. Co. 45 Ohio St. 592; 16 N. E. 110; 18 N. E. 380; McMahan v. Morrison, 16 Ind. 172; 79 Am. Dec. 418n; Indianapolis &c. R. Co. v. Jones, 29 Ind. 465; 95 Am. Dec. 654.

[99] Tysen v. Wabash R. Co. 11 Biss. (U. S.) 510; Indianapolis &c. R. Co. v. Jones, 29 Ind. 465; 95 Am. Dec. 654; Jeffersonville &c. R. Co. v. Hendricks, 41 Ind. 48, 50; Paine v. Lake Erie &c. R. Co. 31 Ind. 283; Wabash &c. R. Co. v. Ham, 114 U. S. 587; 5 Sup. Ct. 1081.

[100] Tysen v. Wabash R. Co. 11 Biss. (U. S.) 510; Compton v. Wabash &c. R. Co. 15 Ohio St. 592; 16 N. E. 110; 18 N. E. 380; 33 Am. & Eng. R. R. Cas. 56.

stockholders in the consolidated corporation an exemption from personal liability which stockholders in the original companies possessed, there being a distinction between a corporation and its stockholders. In a state having a constitutional provision imposing liability on stockholders, if the legislature intends that those of a new corporation created by it shall be exempt, it must express the intention directly, and not commit it to doubtful inference from provisions which apply by name to the corporation.[101]

§ 363. The consolidation of the stock of railroad companies created by the laws of different states, although done with legislative authority, does not constitute the corporations thus consolidating one corporation of both states, or of either, but the corporation of each state continues a corporation of the state of its creation, the same persons as officers and directors managing and controlling the several corporations as one body.[102] The contract of consolidation, and the legislation authorizing and confirming it, create substantially a new corporation with a new name, but such corporation, in a legal point of view, is a distinct corporation in each state, and so remains. A mortgage made after such consolidation, upon the line of road in one state only, is the sole mortgage of the corporation existing in that state, and is legal and valid. Thus corporations existing in Wisconsin and Illinois were consolidated in this way under the name of the Racine and Mississippi Railroad Company. Under this name it executed a mortgage of that part of the road situate in the state of Illinois. There being a corporation having a distinct entity in each of these states bearing this name, the mortgage was regarded as the mortgage of the Illinois corporation. Another railroad corporation of the latter state having been united with the consolidated company, and a mortgage having been made of the entire railroad line in Illinois owned by the Illinois corporation, although the last consolidation may have been illegal, that fact was held not to affect the validity of the mortgage as to that part of the property not owned by the third corporation at the time of the consolidation.

[101] Minneapolis &c. R. Co. v. Gardner, 117 U. S. 332; 20 Sup. Ct. 656.

[102] Racine &c. R. Co. v. Farmers' &c. Co. 49 Ill. 331; 95 Am. Dec. 595. See in illustration of this principle Alabama &c. Mfg. Co. v. Riverdale Cotton Mills, 127 Fed. 497.

The company having issued its bonds and mortgage under such circumstance was estopped from denying its own corporate existence and its own title to the mortgaged property.[103]

When railroad companies organized under laws of different states have each mortgaged their property, and they have, by virtue of the laws of the respective states, consolidated into one company, a holder of the bonds of one of the old companies may enforce payment in the courts of the state in which the mortgaged road is situate, by a foreclosure suit against the consolidated company; and the courts of the other state in which no part of the road was situated and to which it in no way owed its existence, have no jurisdiction to enforce the remedy.[104]

§ 364. A consolidated company is the successor of each of the old companies so far as concerns a right of action of a creditor of one of the old companies; and the property of the old company in the hands of the new is liable for the satisfaction of any judgment he may obtain, if no arrangement is made respecting its liabilities.[105]

[103] Racine &c. R. Co. v. Farmers' &c. Co. 49 Ill. 331; 95 Am. Dec. 595.

[104] Eaton &c. R. Co. v. Hunt, 20 Ind. 457.

[105] Pullman Car Co. v. Missouri Pac. R. Co. 115 U. S. 587; 6 Sup. Ct. 194; Hawkins v. Small, 7 Bax. (Tenn.) 193; 9 Am. & Eng. R. Cas. 432; Mississippi &c. Co. v. Chicago, St. L. &c. R. Co. 58 Miss. 846; 8 Am. & Eng. R. Cas. 575, 580; Chicago &c. R. Co. v. Moffitt, 75 Ill. 525; Miller v. Lancaster, 5 Coldw. (Tenn.) 514; Powell v. North Missouri R. Co. 42 Mo. 63; Columbus &c. R. Co. v. Powell, 40 Ind. 37; North Carolina R. Co. v. Drew, 3 Woods (U. S.), 691; Coggin v. Central R. Co. 62 Ga. 685; 35 Am. R. 132; New Bedford R. Co. v. Old Colony R. Co. 120 Mass. 397; Charity Hospital v. Gas Light Co. 40 La. Ann. 382; 4 So. 433; Ridgway Township v. Griswold, 1 McCrary (U. S.), 151; Prouty v. Lake Shore &c. R. Co. 52 N. Y. 363; Chase v. Vanderbilt 62 N. Y. 307; Tagart v. Northern Central R. Co. 29 Md. 557; Bruffett v. Great Western R. Co. 25 Ill. 353; Powell v. North Missouri R. Co. 42 Mo. 63; Selma &c. R. Co. v. Harbin, 40 Ga. 706; Tysen v. Wabash &c. R. Co. 11 Biss. (U. S.) 510; Montgomery &c. R. Co. v. Branch, 59 Ala. 139; Compton v. Wabash R. Co. 45 Ohio St. 592; 16 N. E. 110; 18 N. E. 380; Berry v. Kansas City R. Co. 52 Kans. 774; 36 Pac. 724; 39 Am. St. 381; State v. Baltimore &c. R. Co. 77 Md. 489; 26 Atl. 865; Thompson v. Abbott, 61 Md. 176; Langhorne v. Richmond R. Co. 91 Va. 369; 22 S. E. 159, citing text; United States &c. Co. v. Isaacs, 23 Ind. App. 533; 55

It is also held that a suit pending against a corporation does not abate upon its consolidation with another company, but the same suit may be prosecuted against the consolidated corporation.[106]

But in respect to the property of other companies, which have joined in the consolidation, the consolidated company is a new and independent company as to the creditors of one of the old companies, and such creditors have no claim against the new property unless the new company has expressly assumed the obligations of the old. An action having been commenced against the Michigan Southern and Northern Indiana Railroad Company and its officers in New York, where it was a foreign corporation, it afterwards consolidated with the Lake Shore Railway Company and with the Buffalo and Erie Railroad Company, pursuant to the laws of the several states by which the original companies were incorporated, and the consolidated companies were known by the name of the Lake Shore and Michigan Southern Railway Company. Upon a reference, a judgment for the amount claimed was reported, with an order restraining the defendant corporation from making any dividends until the amount was paid. After the coming in of the report, an order was made substituting the Lake Shore and Michigan Southern Railway

N. E. 832; Bertholdt v. Holladay-Klotz &c. Co. 91 Mo. App. 233; Warren v. Mobile &c. R. Co. 49 Ala. 582; Louisville &c. R. Co. v. Boney, 117 Ind. 501, 504; 20 N. E. 432; 3 L. R. A. 435n. In the latter case the court say: "While it is an open question in some jurisdictions whether or not, in the absence of a statute, the debts of the original companies follow as an incident of the consolidation, and become by implication the obligations of the new corporation, it is settled in this state that the act of consolidation involves an implied assumption by the new company of all the valid debts and liabilities of the consolidated companies. Indianapolis &c. R. Co. v. Jones, 29 Ind. 465; 95 Am. Dec. 654; Columbus &c. R. Co. v. Powell, 40 Ind. 37; Jeffersonville &c. R. Co. v. Hendricks, 41 Ind. 48. The rule which the authorities support seems to be that, where one corporation goes entirely out of existence by being incorporated into another, if no arrangements are made respecting the property and liabilities of the corporation that ceases to exist, the corporation into which it is merged will succeed to all its property, and be answerable for all its liabilities. After consolidation the liability of the new company is substituted for that of the original companies, which have, to all intents and purposes, ceased to exist." Per Mitchell, J.

[106] Evans v. Interstate &c. R. Co. 106 Mo. 594; 17 S. W. 489.

Company and its officers as defendants. Upon appeal this latter order was held erroneous, as it made the consolidated company and its officers liable upon the original contracts, and subjected them and all the property of the consolidated company to the restraint adjudged against the old company. The effect of the substitution is not merely to continue against the new corporation and its officers proceedings which affected the property of the original defendants, but to subject the property of two other companies to judgment rendered subsequently to the consolidation in an action to which they were not parties.[107]

After the consolidation of two or more companies into one under a new name, a suit may be maintained against it by that name upon a note or bond executed by one of the consolidated companies. The company is estopped from denying the name by which it is sued. The old company which executed the obligation has, by force of the consolidation, assumed the new name.[108]

§ 365. Where the articles of consolidation of two railway companies provide that the new company shall assume the debts and liabilities of the old companies, and shall carry out all their unexecuted contracts, and the act of legislature ratifying and confirming the consolidation saves the rights and remedies of creditors, a creditor of one of the old companies may maintain his action against the new company.[109] The consolidated company, though having a new name, is estopped to deny the name by which it is sued.[110] And so, where property is transferred to the consolidated company subject "to all liens, charges, and equities pertaining thereto" in the hands of the orginal companies, such obligations devolve upon the consolidated company, and can be enforced against it.[111]

[107] Prouty v. Lake Shore &c. R. Co. 52 N. Y. 363.

[108] Columbus &c. R. Co. v. Skidmore, 69 Ill. 566; Columbus &c. R. Co. v. Powell, 40 Ind. 37. But the consolidated company is not liable for the tort of a constituent company committed before the consolidation. Joseph v. Southern R. Co. 127 Fed. 606.

[109] Western Union R. Co. v. Smith, 75 Ill. 496; Montgomery &c. R. Co. v. Branch, 59 Ala. 139; Gilmer v. Mobile &c. R. Co. 79 Ala. 569; 58 Am. R. 623; Mobile &c. R. Co. v. Gilmer, 85 Ala. 422; 5 So. 138.

[110] Columbus &c. R. Co. v. Skidmore, 69 Ill. 566.

[111] Union Pacific R. Co. v. McAlpine, 129 U. S. 305; 9 Sup. Ct. 286.

When a consolidated company becomes, by virtue of the consolidation, liable for the debts of the companies composing it, the creditors' remedy is complete and adequate at law, and a court of equity will not assume jurisdiction to enforce it.[112]

When a new corporation formed by the consolidation of two or more other corporations assumes the debts and obligations of the original companies, a cause of action by a holder of preferred or guaranteed stock of one of the old companies, to enforce an alleged contract to pay specified dividends upon such stock, is against the new corporation, and its officers are not necessary or proper parties to the action.[113] "A judgment or decree against the corporation is binding upon the directors as well as upon all classes of stockholders. It affects the common property of all; and if at any time or for any reason, during the progress of a litigation, it is made to appear that the directors do not or cannot properly protect the special interest of any class, courts, upon application, would have the power to give the necessary relief or an opportunity to be heard. As the directors are under the same obligation to all the stockholders they represent, they cannot be charged by a plaintiff in an action with the duty of especially taking care of and protecting the interests of one class of stockholders as against the others; and if for any sufficient reason the common stockholders, in person or as representatives, are necessary or proper parties, the plaintiff should select other stockholders not having an official relation to the company, not those whose general duty might conflict with special interests, and thus render them improper representatives of a particular class of stockholders."

If one of the consolidated companies holds its property subject to a vendor's lien for a part of the purchase money due for land, the consolidation does not discharge the lien. The consolidated company has the same notice of the lien that the first company had.[114]

§ 366. A consolidated company is not the same as one of its constituents as regards an executory contract with a stranger to

[112] Arbuckle v. Illinois &c. R. Co. 81 Ill. 429.

[113] Chase v. Vanderbilt, 62 N. Y. 307, 315.

[114] North Carolina R. Co. v. Drew, 3 Woods (U. S.), 692.

an undertaking to deliver bonds. The New Jersey, Hudson and Delaware Railroad Company, having agreed to deliver to subscribers bonds of the company in consideration of moneys to be paid in instalments as the work upon the railroad should go forward, became amalgamated with two other companies under the name of the New Jersey Midland Railway Company, and having tendered the bonds of the consolidated company, brought suit upon the subscriptions. It was claimed that the company had not ceased to exist, but had merely changed its name and form of organization. It was held that the suit would not lie, the bonds offered not being those agreed for; just as the bonds of a road of ten miles in length are different securities from bonds of a company having a road a hundred miles long.[115]

§ 367. **A new company formed by consolidation under statutory authority is not entitled to an exemption from taxation** secured to one of the constituent companies by its charter, but the new company holds its property and franchises subject to the organic law in relation to taxation in force at the time of the consolidation.[116]

§ 367a. **A "succession" takes place when the property and franchises of a corporation are purchased at private sale,** which differs from a consolidation in this respect, that the purchaser thus acquiring the property and franchises of the selling corporation does not become responsible for its liabilities already accrued.[117]

§ 367b. **After its dissolution a bill to foreclose, filed by the trustee in a mortgage or deed of trust, cannot be maintained** against the corporation itself. The claim thereby set up can be asserted only in the dissolution proceedings. The powers conferred upon the trustees by the instrument can be exercised by them after the dissolution of the corporation, if like powers granted by an individual could be exercised by his donees after his death. But judicial proceedings against the estate of a dissolved corporation must follow the course

[115] New Jersey &c. R. Co. v. Strait, 35 N. J. L. 322.

[116] St. Louis &c. Ry. Co. v. Berry, 113 U. S. 465; 5 Sup. Ct. 640; Louisville &c. R. Co. v. Palmes, 109 U. S. 244; 3 Sup. Ct. 193; Yazoo &c. R. Co. v. Adams, 180 U. S. 1; 21 Sup. Ct. 240. See § **693.**

[117] Pennison v. Chicago &c. R. Co. 93 Wis. 344; 67 N. W. 702.

prescribed by statute. The bill to foreclose should, under the local statute, be treated as a claim filed in the dissolution proceedings, as it must be so treated to be regarded as properly presenting the claim sought to be enforced.[118]

IV. *In Cases of Concurrent Jurisdiction, the Court which first assumes Jurisdiction retains it.*

§ 368. **Where two or more courts have concurrent jurisdiction of the same subject-matter of litigation, that in which suit is first brought** should be left to adjudicate between the parties. Any court in which suit upon the same matter is afterwards brought should, upon being advised of the pendency of the suit in a court of competent jurisdiction, and having precedence in point of time, dismiss the bill and discharge its receiver, if one has been appointed.[119]

Jurisdiction of a cause and of the subject-matter of it once obtained by one court cannot be taken away by proceedings in another court of coordinate jurisdiction. After a bill had been filed in the Circuit Court of the United States for the foreclosure of a mortgage, a compromise agreement was made, providing among other things for the conversion of a portion of the bonds into stock, and a new organization of the company, which the court ratified in the form of a decree. On the faith of the decree, bonds had been surrendered and stock taken, the property placed in the hands of a trustee, who was authorized to incur debts and pledge property to secure them. The decree, so far as it provided for the conversion of

[118] Nelson v. Hubbard, 96 Ala. 238; 11 So. 428; 17 L. R. A. 375.

[119] Keep v. Michigan &c. R. Co. 6 Chicago Legal News, 101; Milwaukee &c. R. Co. v. Milwaukee &c. R. Co. 20 Wis. 165; 88 Am. Dec. 735; Weymouth v. Roselius, 36 La. Ann. 527; Fernald v. Spokane &c. Tel. Co. 31 Wash. 219; 71 Pac. 731; Lloyd v. Chesapeake &c. R. Co. 65 Fed. 351; State v. Jacksonville &c. R. Co. 15 Fla. 201; O'Mahoney v. Belmont, 62 N. Y. 133; Baltimore &c. R. Co. v. Wabash R. Co. 119 Fed. 678; Hardrader v. Wadley, 172 U. S. 148; 19 Sup. Ct. 877; 43 L. Ed. 399; Farmers' &c. Co. v. Lake St. R. Co. 177 U. S. 51; 20 Sup. Ct. 564; 44 L. Ed. 667; Central Trust Co. v. South Atlantic &c. R. Co. 57 Fed. 3; Carey v. Houston &c. R. Co. 52 Fed. 671.

bonds into stock, could not, of course, be made effectual without the consent of the bondholders, for that would be changing the contract without their consent. Any bondholder who had not become a party to the agreement could proceed to enforce a foreclosure of the mortgage, and this court, rather than a state court, was the proper tribunal for that purpose. "It was not possible," said Judge Drummond,[120] "that the cause could be divided into fragments, and, in the actual state of affairs, one party in interest go to one court, and another to a different court, for the enforcement of his equitable rights. If the understanding of the parties and the terms of the decree were entirely carried out, there would be no difficulty; but if in that way their expectations were not realized, and there should be a failure to satisfy the claims of the creditors, there would seem to be no question that this court was the proper tribunal to do equity, because it was only by control over the orders of the court already made that this could be accomplished." The trustee should also report to that court, and any of the parties in interest had the right to insist upon his so reporting. He had no right to turn over to another tribunal matters which have been partially adjudicated in the Circuit Court, for that was the only court whose decision upon the matters involved would be binding upon the parties. Therefore, when the trustee, during the pendency of this suit, without the permission of that court, filed a bill in a state court to foreclose the same mortgages which were the subject of the bill in the Circuit Court, and a receiver was appointed and a sale made in the state court, and the property delivered to the purchaser, such an interference on the part of the state court with property at the time within the jurisdiction of the Circuit Court was unauthorized, and the latter court has nevertheless jurisdiction of the property, and a bondholder is entitled to the equitable interposition of the court to protect his rights, and to demand an account from the trustee or his representatives. As to the effect of the proceeding in the state court upon the jurisdiction of the Circuit Court over the cause and the subject-matter of it, Judge Drummond said: "There can be no doubt it has created great confusion in the position of those claiming under the mortgages, and embarrassment in the court to deal properly with their interests. It has thus brought about an appar-

[120] Bill v. New Albany R. Co. 2 Biss. (U. S.) 390, 399, 401.

ent conflict between courts, state and federal, which should always be avoided. But the conflict arises from acts done after the court had obtained jurisdiction of the cause, and for which, therefore, it cannot be justly held accountable; and when a party affected by an order or decree entered in a pending cause asks for relief, it is no answer to say that another jurisdiction has attempted to seize the property, and thus place it beyond the power of the court to give relief. The question always must be, Is it competent for the court to act? If so, its duty is plain, and it necessarily follows from what has been said that, in my opinion, the property is still within the control of this court to adjudicate upon the equitable rights of all who have ever been before it."

§ 369. The court having control of the main suit has of course direct control of the receiver appointed in the case, of all moneys coming to his hands, of the distribution of the same, and of the distribution of all funds derived from the sale of the property under decree. A creditor applying for payment of his claim out of the earnings of the road should make his application to the court in which the original bill was filed, and not to an ancillary court.[121] But it seems that a lien creditor who has not filed his claim in the original suit may intervene in the subsequent suit to establish his lien.[122]

Where a creditor intervenes in a foreclosure suit for the purpose of establishing a lien, he cannot dismiss his suit without prejudice and proceed to litigate his claim in another tribunal. Such a creditor voluntarily becomes a party to the foreclosure proceeding in the federal court, sets up his claim and is bound by the foreclosure decree, providing the purchaser takes the property subject to such liens as shall be adjudged prior liens, and for giving a right to appeal from all judgments regarding priority. The creditor is bound by the provisions of that decree which secures to the purchasers of the property the right to litigate their claims in that forum, and cannot escape this provision by dismissing his petition without prejudice.[123]

[121] Central Trust Co. v. East Tenn. &c. R. Co. 30 Fed. 895.

[122] Fidelity &c. Co. v. Shenandoah &c. R. Co. 32 W. Va. 244; 9 S. E. 180.

[123] Tolle v. Owensboro &c. R. Co. 111 Ky. 623; 64 S. W. 455.

§ 370. Proceedings in a second foreclosure suit pending the prior suit.—After a foreclosure suit has been commenced, so long as it is pending and the court retains jurisdiction of the cause, other proceedings for the same purpose in another court are irregular and void, although prosecuted under the supposition that the proceedings in the former case were ended. Thus, a suit having been commenced in the Circuit Court of the United States for the District of Indiana, in 1857, to foreclose mortgages given by the New Albany and Salem Railroad Company, and a decree having been entered by consent declaring the rights and interests of the bondholders under the several mortgages and of the stockholders, the purpose of which was to effect a reorganization of the company, no further proceedings were had, when nearly ten years afterwards, in August, 1868, some of the bondholders demanded that the trustee should take proceedings to foreclose the mortgages. The trustee, acting upon the assumption that the original suit brought in the Circuit Court for that purpose had been ended by the decree referred to, commenced suit for the foreclosure desired in a court of the State of Indiana. This suit proceeded to a final decree, under which the property was sold to purchasers who organized themselves into a new company. The holder of a subsequent mortgage bond then petitioned the Circuit Court, in which the original suit was commenced, for the appointment of a receiver in that suit, upon the assumption that this court still retained jurisdiction of the suit and the mortgaged property. This view was sustained by the Circuit Court; and the successor of the trustee who had brought suit in the state court was led to apply for leave to file a supplemental bill for the foreclosure of the mortgages, and his application was granted.[124]

One of the questions which arose upon this supplemental bill was whether a process of subpœna should have issued upon it. The Supreme Court of the United States held that this is only necessary where new parties are brought in. The supplemental bill is a mere adjunct to the original bill, and, where the parties have already been served, no further subpœna for them is required.[125]

§ 371. The pendency of a foreclosure suit in a state court is no

[124] Bill v. New Albany R. Co. 2 Biss. (U. S.) 390.

[125] Shaw v. Bill, 95 U. S. 10.

bar to a suit in a federal court, where the property is not in the custody of the state court by its officers or appointees, and where the suit in that court is not between the same parties, or those fully authorized to represent the same parties, in the same behalf, and for the same relief.[126]

A federal court may even proceed with a foreclosure suit although another foreclosure suit is pending between different parties in the state court, and the property is in possession of a receiver of that court; but the federal court will do nothing to disturb such possession, or to interfere with the receivership.[127]

V. *Sale of Franchise or Property of Railroad Company on Execution.*

§ 372. The franchise of a railroad company, or of any similar corporate body, and corporate property essential to the enjoyment of the franchise, are not subject to sale on execution, unless the legislature assents to the transfer.[128] This is the common law rule, and a statute authorizing a sale of a franchise on execution, being in derogation of the common law, will be strictly construed. Thus, if the statute provides for a sale of the franchise for the shortest period that will satisfy the execution, a sale of the franchise for a certain period in part payment of the execution is void.[129] As already no-

[126] Brooks v. Vermont &c. R. Co. 14 Blatchf. (U. S.) 463; Mercantile Trust Co. v. Lamoille, &c. R. Co. 16 Blatchf. (U. S.) 324. See, also, Pond v. Vermont &c. R. Co. 12 Blatchf. (U. S.) 280; Parsons v. Greenville &c. R. Co. 1 Hughes (U. S.), 279; Loring v. Marsh, 2 Cliff. (U. S.) 311; East Tennessee &c. R. Co. v. Atlanta &c. R. Co. 49 Fed. 608.

[127] Mercantile Trust Co. v. Lamoille &c. R. Co. 16 Blatchf. (U. S.) 324.

[128] Gue v. Tide Water Canal Co. 24 How. (U. S.) 257; Tippets v. Walker, 4 Mass. 595, 597, per Parsons, C. J.; Ludlow v. Hurd, 1 Dis. (Ohio) 552; Ammant v. New Alexandria &c. Road Co. 13 S. & R. (Pa.) 210; 15 Am. Dec. 593n; Leedcm v. Plymouth R. Co. 5 W. & S. (Pa.) 265; Stewart v. Jones, 40 Mo. 140; Wood v. Truckee Turnpike Co. 24 Cal. 474; Thomas v. Armstrong, 7 Cal. 286; Munroe v. Thomas, 5 Cal. 470; Hatcher v. Toledo, Wabash &c. R. Co. 62 Ill. 477; Oakland R. Co. v. Keenan, 56 Pa. St. 198. Contra, State v. Rives, 5 Ired. (N. C.) L. 297.

[129] James v. Pontiac &c. Plank

ticed,[130] privileges granted to corporations of a public character are conferred with a view to the public use and accommodation, and they cannot voluntarily deprive themselves of their franchises, or of their property necessary for the exercise of these franchises; and in pursuance of the same policy the franchises and property of such corporations are not allowed to be taken from them on execution, because this would tend to defeat the whole object of the charter, and either to place the property and franchises in the hands of parties to whom it had not been confided, or else to break up and destroy the corporation and render its improvements useless to the public.[131] A levy cannot be made upon any essential part of the property of a railroad company, such as freight and passenger houses, and the lands connected therewith.[132]

A turnpike road cannot be levied upon by a judgment creditor. Aside from the remedy that might be afforded by a court of chancery, there is no remedy for the collection of debts against such property, unless it be given by statute, in the nature of a sequestration, to take the net profits after providing for the repair and maintenance of the road. Real estate of the company not necessary for the use of the road may be taken on execution; but if such real estate be blended with the road in one levy, so that it is difficult to separate them, the court will set aside the whole proceedings.[133]

The principle running through all the cases is that the property of a public corporation, such as a railroad, cannot be sold separately and apart from its franchise if the property is so indissolubly linked to the franchise and to its public functions as that without it the

Road Co. 8 Mich. 91; and see Seymour v. Milford &c. Turnpike Co. 10 Ohio, 476.

[130] § 1–25.

[131] Susquehanna Canal Co. v. Bonham, 9 W. & S. (Pa.) 27; 42 Am. Dec. 315.

[132] Georgia v. Atlantic &c. R. Co. 3 Woods (U. S.), 434.

[133] Ammant v. New Alexandria &c. Road Co. 13 S. & R. (Pa.) 210; 15 Am. Dec. 593n, and confirmed by Susquehanna Canal Co. v. Bonham, 9 W. & S. (Pa.) 27; 42 Am. Dec. 315. This same doctrine has been applied to the levy on property of a bridge company. Overton Bridge Co. v. Means, 33 Neb. 857; 51 N. W. 240; 29 Am. St. 514. Certain New Jersey statutes—Gen. Stat. p. 3694. §§ 34, 35—have been held not to give a right to levy on the franchise of a turnpike company. State v. Turnpike Co. 65 N. J. L. 73; 46 Atl. 569.

franchise will be rendered inoperative. The remedy of a creditor who has exhausted property not necessary to the exercise of the franchises is to obtain a receiver, and sequester the tolls or income.[134]

§ 372a. **By the Constitution of Texas[135] the real and personal property of any railroad corporation, or any part of it, shall be liable to execution** and sale in the same manner as the property of individuals. By virtue of this provision it has been held that a depot and depot grounds could be levied on and sold, the Constitution making no distinction on account of the use made of the land by the company.[136]

§ 373. **The mere fact that the property of a railroad is subject to a mortgage does not operate to exempt such property,** which is in its nature personal, from being levied upon by judgment creditors of the company so long as the mortgagee has not taken possession under the mortgage. The only remedy of the mortgagee in such case is to invoke the interposition of a court of equity to prevent further proceedings upon the execution; and it is said that such proceedings will not be enjoined until the mortgagee has taken possession, or has commenced proceedings to foreclose the mortgage,[137] though an injunction will be granted upon its appearing that the mortgage security is inadequate.[138] It is not sufficient, however, to show that the constant and uninterrupted use and enjoyment of the property by the railroad company is indispensable to enable it to earn money with which to pay the interest as it becomes due. It must be averred and proved that the security would be affected to entitle the mortgagee to this relief.[139]

But without any such allegations an injunction will be granted, at the suit of trustees in possession of and operating a railroad, to restrain the seizure of a locomotive off the line of the road, under a process of attachment or execution.[140]

[134] Connor v. Tennessee &c. R. Co. 109 Fed. 931.

[135] Const. of 1875, art. 10, § 4.

[136] Texas-Mexican R. Co. v. Wright, 88 Tex. 346; 31 S. W. 613; 31 L. R. A. 200n.

[137] Eells v. Johann, 27 Fed. 327.

[138] Coe v. Peacock, 14 Ohio St. 187; Lane v. Baughman, 17 Ohio St. 642; Coe v. Columbus &c. R. Co. 10 Ohio St. 372, 380.

[139] Coe v. Knox County Bank, 10 Ohio St. 412; 36 Am. Dec. 95.

[140] Felton v. Crisfield, 4 Del. Ch. 573.

A corporation upon whose property an execution has been levied cannot itself claim protection against the execution, and obtain an injunction against a sale under the execution, upon the ground that the property is covered by mortgage; whatever protection the mortgagee is entitled to must be asserted by himself.[141]

If the property has already been attached in a suit in a state court, when a receiver is appointed by the Circuit Court of the United States, the receiver should ask to be made a party to the attachment suit, and then make his defense. He cannot dispose of the attachment suit by petitioning the court in which that suit is pending to order the property levied on to be turned over to him. A court of equity might restrain a sale under the attachment suit pending the determination of the question of the receiver's rights.[142]

A judgment which is a prior lien is not defeated by a sale of the property in a foreclosure suit.[143]

§ 374. Any property which is a part of a railroad mortgaged as an entire property is exempt from execution. Rails and chairs, lying by the track in readiness for repairs or reconstruction, are not liable to levy and sale on execution as against a mortgagee of the road;[144] nor, according to some authorities, are they so liable as personal property even as against the railway company itself. The general principle governing this matter is stated in Sheppard's Touchstone:[145] "That which is parcel or of the essence of a thing, albeit at the time of the grant it be actually severed from it, doth pass by the grant of the thing itself. And therefore, by the grant of a mill the millstone doth pass, albeit at the time of the grant it be actually severed from the mill. So by the grant of a house, the doors, windows, locks and keys, do pass as parcel of it, albeit at the time of the grant they be actually severed from the house."

A mortgage of the entire property of a railroad company, both that which it has at the time and that which it may afterwards

[141] Boyd v. Chesapeake &c. Canal Co. 17 Md. 195; 79 Am. Dec. 646.

[142] South Carolina R. Co. v. People's Sav. Inst. 64 Ga. 18.

[143] Blair v. Walker, 26 Fed. 73; Blair v. St. Louis &c. R. Co. 27 Fed. 176.

[144] Covey v. Pittsburgh &c. R. Co. 3 Phila. (Pa.) 173; Fahs v. Roberts, 54 Ill. 192, 194. See §§ 154–163

[145] Sheppard Touch, page 90.

acquire, together with its tools and income, covers wood bought for its use; and therefore a judgment creditor may be enjoined from selling and removing such property, on petition of the mortgagees, when it appears that the whole property mortgaged is inadequate to satisfy the mortgage debt.[146] The remedy of a judgment creditor in such case is in equity, to have the interest of the mortgagor ascertained and subjected, in such mode as may be consistent with the rights of the prior incumbrances, to the payment of his judgment. Under a mortgage which contains an express reservation of "so much of the income as might be necessary to pay for the running expenses and repairs" of the road, when the nature of a claim against the road is such as to entitle the creditor to have it paid out of the earnings of the company, this may be accomplished by appropriate proceedings in equity. A claim for damages, on account of stock killed upon the road, would doubtless come within such an exception, and perhaps, even without such express reservation, it ought to be regarded as an incidental liability incurred by the company operating the road, and to be deducted from the earnings before the net income covered by the mortgage could be ascertained.[147]

§ 375. **But in Minnesota personal property not rolling stock or appertaining to the road may be seized upon execution,** even as against a mortgagee. Lumber or cordwood belonging to a railroad company whose property is subject to mortgage is subject to levy and sale upon execution by a judgment creditor of the company. Such sale divests the company of its property in the lumber or wood, and passes it to the purchaser. It severs whatever relation or connection of appurtenances or otherwise that existed between the lumber or cord-wood and the railroad, and the running or operating of the same. A receiver, subsequently appointed in a suit for foreclosure, cannot recover possession of such property. Power conferred upon such receiver to take possession of the railroad and its property, "and also all other goods and chattels owned by said com-

[146] Lane v. Baughman, 17 Ohio St. 642; Coe v. Peacock, 14 Ohio St. 187. See, however, Fahs v. Roberts, 54 Ill. 192, 194.

[147] Lane v. Baughman, 17 Ohio St. 642, 648, per White, J. See § 603.

pany in any way relating to or appertaining to or connected with said railroad, or the running or operating of the same," does not avail the receiver, because such property was not owned by the company, the prior sale having divested it of all title to this property.[148]

Under the present Minnesota statute, rolling stock and property belong to the road and appertaining thereto of a mortgagor railroad cannot be sold on execution. Mortgagees can maintain a suit for an injunction against a threatened sale. [149]

§ 376. **In a sale of property to a railroad company a stipulation as to the time of the passing of title is binding** between the parties to the contract, and also as against creditors of the company who have notice of such contract. Thus the St. Joseph and Denver City Railroad Company, having purchased ties under an agreement that they should not be considered the property of the company until placed under the rail, a creditor of the company, knowing the terms of the contract, could acquire no title to such ties by a levy and sale on execution after the company had taken possession of the ties and moved them to different places along the line of the road. Such a sale is conditional, and until the condition is performed no title passes.[150]

§ 377. **The appropriate remedy of a judgment creditor against a railroad corporation is by application to a court of equity,** seeking a discovery as to the condition of the company: and upon the failure of the officers to pay when directed, the chancellor may take possession of the road through a receiver, and apply the net income or any surplus fund to the payment of the creditor's claim. "To permit every and any agent of a corporation like this to be garnisheed before or after judgment would result in the sacrifice of all the private and public interests connected with it. The chancellor, by giving to the creditor the income of the road, retaining enough to defray the necessary expenses of the corporation, has given him all that he has the right to demand, and at the same time preserves

[148] McIlrath v. Snure, 22 Minn. 391.

[149] Central Trust Co. v. Moran, 56 Minn. 188; 57 N. W. 471; 29 L. R. A. 212. See § 158.

[150] Owens v. Hastings, 18 Kans. 446.

the corporate property for private and public use. Nor does this ruling prevent a corporation from being garnisheed as the debtor of a third party, whose creditor is seeking to make his debt. In such a case, however, the court will require payment to be made in the same manner as if the company were the real debtor."[151]

This is the practice adopted in England.[152] The Supreme Court of the United States in like manner, where there was a judgment at law against a bridge company, under which the tolls were sold in execution, approved of the appointment in equity of a receiver to collect tolls and pay them in to court, to the end of discharging the judgments at law. The court declared that the remedy at law of creditors holding executions against corporations is exceedingly embarrassed, and that they could not obtain satisfaction of their judgments unless equity afforded relief.[153]

Where a judgment is by law a lien upon the debtor's real estate, and a railroad company is by statute the owner in fee of the real estate taken for its right of way, as is the case in Wisconsin, a suit in equity may be brought to have a judgment against a railroad company declared a lien; and upon a sale under a decree, followed by a conveyance duly confirmed by the court, the whole interest of the company existing at the time of the rendition of the judgment passes to the purchaser.[154]

In Massachusetts it is provided that the franchise of a turnpike or other corporation authorized to receive toll, and all the rights and privileges thereof, are liable to attachment on mesne process and to sale on execution. In the sale of such franchise,

[151] Wilder v. Shea, 13 Bush (Ky.), 128.

[152] Blanchard v. Cawthorne, 4 Sim. 566; Fripp v. Chard R. Co. 11 Hare, 241.

[153] Covington Drawbridge Co. v. Shepherd, 21 How. (U. S.) 112, 124; and see Macon &c. R. Co. v. Parker, 9 Ga. 377. Conceding, however, that considerations of public policy, or the peculiar nature, uses and incidents of property owned by such quasi public corporations, forbid the sale upon execution of the whole or parts of the property, with or without the corporate franchise, it does not follow that a lien upon it may not be created by the recovery of a judgment against the corporation, which may be preserved in some mode, and enforced in some appropriate proceeding. Stewart v. Wheeling &c. R. Co. 53 Ohio St. 151; 41 N. E. 247; 29 L. R. A. 438.

[154] Railroad Co. v. James, 6 Wall. (U. S.) 750.

the person who satisfies the execution with all fees and expenses, or who agrees to take such franchise for the shortest period of time, and to receive during such time all such toll as the corporation would by law be entitled to demand, is considered the highest bidder. The corporation retains its powers in all other respects than that to take the tolls, and is bound to the discharge of its duties just as it was before the sale.[155]

§ 378. Statutory provisions for enforcing executions against railroad companies.—In New York the mode appointed by law for the collection of a judgment against a railroad company, after the return of an execution unsatisfied, is by an action in which a receiver is appointed and the property of the company sequestered for the creditor's benefit.[156]

In Pennsylvania it is provided by statute that a judgment creditor of a corporation may have execution by *fieri facias,* which shall command the sheriff to levy upon any personal or real property, franchises, and rights of such corporation, and sell the same. The levy may extend to the property, franchises, and rights of the corporation in every county of the commonwealth, and the sale thereof is as effectual as though all the property and rights were located and levied upon and sold in the county wherein the execution was issued.[157] Insolvent corporations are proceeded against by sequestration.[158] A purchaser at an execution sale of the property and franchises of a railroad company takes only the equity of redemption subject to the mortgage; and this is the case though the judgment be recovered by a holder of a part of the bonds secured by the mortgage for interest due upon the bonds held by him.[159]

[155] Gen. Stat. 1860, ch. 68, §§ 25–34. There is a somewhat similar statute in Delaware. R. Code 1874, pp. 377, 378.

[156] 3 R. S. (5th ed.) 763, § 44; 1 Laws 1870, ch. 422, § 3; Loder v. New York &c. R. Co. 4 Hun (N. Y.), 22. The receivership so provided for should be restricted to such property as had not been incumbered by prior mortgage, or the property of the corporation subject to the mortgage. A receiver in the action to foreclose the mortgage may have the appointment of a receiver in the action for sequestration vacated. Whitney v. New York, &c. R. Co. 32 Hun (N. Y.), 164.

[157] Act of 1870, p. 58, § 1; 1 Brightly's Pudon's Dig. 291.

[158] Oakland R. Co. v. Keenan, 56 Pa. St. 198.

[159] Commonwealth v. Susquehan-

In a late case the sale by a sheriff upon a judgment of part of a road lying in one state seems to have been regarded as an unjustifiable abuse of a legal right which would be restrained on a bill filed by any bondholder.[160]

In Virginia the road and franchises of a railroad company are liable for the payment of judgments recovered against it. Instead of selling the interest of the corporation to satisfy a small debt, the court may direct a lease of it to be made for the shortest period for which a sufficient rent may be obtained to pay the debt and the costs of suit. If to accomplish this object it is necessary to lease the railroad for a term which will yield in rents a sum far exceeding the amount of the judgment and it cannot be leased for a shorter term, the creditors are entitled to have it leased for the longer term.[161]

Likewise in Kentucky a railroad and its appurtenances are treated in law as one entire thing, which cannot be sold in parcels to enforce the payment of taxes, as for instance all of the road in one county cannot be sold for the payment of the tax within that county. Fragmentary taxations or sales might be unjustly vexatious and injurious to the owners, and might disturb the public use and interest.[162]

In Georgia a chartered railroad, with all its rights and privileges, including its corporate franchise, is property subject to be applied to the payment of its debts, and may be sold under a judgment at law. The franchise of the company is property. It is in fact the chief value of a railroad. There is no exemption of any property of a corporation from the payment of its debts. The judgment and execution must be framed upon equitable principles, although, under the peculiar system in this state, a court of law may generally administer as ample relief as a court of equity.[163]

In Mississippi the equity of redemption of a railroad company

na &c. R. Co. 122 Pa. St. 306; 15 Atl. 448; 1 L. R. A. 225; 36 Am. & Eng. R. Cas. 269; Western Penn. Hospital v. Mercantile Library Hall Co. 189 Pa. St. 269; 42 Atl. 183.

[160] Dupont v. Bushong (U. S. C. C.), 1 Wkly. Notes Cas. 378.

[161] Winchester &c. R. Co. v. Colfelt, 27 Gratt. (Va.) 777.

[162] Applegate v. Ernst, 66 Ky. 648; 96 Am. Dec. 272.

[163] Atlanta v. Grant, 57 Ga. 340, 346. In regard to the franchise of the corporation the court said that without it the railroad would be almost worthless. "To own it would be like owning a horse with no right to ride him or drive him,—

is subject to sale for the payment of the company's debts, however long a time the mortgage may have to run. A resort to chancery is now necessary in all cases.[164]

In Texas,[165] the road-bed, track, franchise, and chartered rights and privileges of any railroad company are made subject to the payment of its debts and legal liabilities, and may be sold in legal satisfaction of the same; but whenever judgment is rendered against any railroad company, the party in whose favor such judgment is rendered may have execution thereon, directed to the sheriff of that county in which the principal office of said company is kept; and if the said company fails to point out other property to satisfy said execution, the sheriff may, at the request of the plaintiff, levy the same upon the road-bed, track, franchise, and chartered powers and privileges of said company; and said levy is held to embrace the whole road-bed, and track, and entire line of said railroad, whether situated in the same county or not; and he is required to proceed to advertise and sell the same at the court-house door of his county, as in other cases, making the same advertisement as is provided by law in cases of the sale of lands; and upon said sale, to execute to the purchaser a conveyance of the said road-bed, track, franchise, chartered powers, rights and privileges.

In California,[166] for the satisfaction of any judgment against a corporation authorized to receive tolls, its franchise, and all the rights and privileges thereof, may be levied upon and sold under execution, in the same manner and with like effect as any other property. The purchaser at the sale receives a certificate of purchase of the franchise, and is immediately let into the possession of all property necessary for the exercise of the powers, and the receipt of the proceeds thereof, and must thereafter conduct the business of such corporation, with all its powers and privileges, and subject to all its liabilities, until the redemption of the same, which may be made at any time within one year after such sale.

no right to put him to labor. This would be owning materials merely; the iron and timbers, the earth and masonry, of the railroad, or the hide and flesh and bones of the horse."

[164] Vicksburg &c. R. Co. v. McCutchen, 52 Miss. 645.

[165] Paschal's Dig. 1866. p. 820, arts. 4912, 4914.

[166] Codes and Stats. 1876, §§ 5388, 5389, 5392, 5393. The same statute was reenacted in Dakota T. Civil Code 1877, §§ 442–447.

In Maryland it has been held that property which from its nature, location, and connection with a canal and the use previously made of it, is essential to the operation of the canal, is not liable to execution. A judgment creditor has no equity against bondholders and trustees for bondholders, whose security would be affected by allowing the property levied on to be diverted from its present lawful use, are entitled to have the execution restrained by injunction. It is not a question whether the property be absolutely necessary or indispensable to the operation of the work, but whether it has been used, or is of a nature to be of practical use in operating the work.[167]

§ 379. **Funds in possession of the president, officers, and agents of a railroad company are not subject to garnishment** in an ordinary action by a creditor against the company.[168] Their possession is the possession of the company, and to garnishee them in an action against the company is to garnishee the debtor, and not a creditor of the debtor. Such a proceeding is in effect an attempt "to compel the corporation to pull the money out of its pocket."[169] Funds in the possession of the president or other officer of a corporation authorized to receive and hold them for the company are in the possession of the company,—are in its treasury, and not in the possession of the officer as an individual. "The servant who feeds, waters, and curries his master's horse, and keeps the key of the stable, the master having the actual and dominant possession and control; the clerk who opens and shuts the store and sells the goods, subordinate to the actual possession of the merchant; the treasurer of the corporation who has charge of the safe and the moneys therein, and receives and pays out, under the immediate direction and control of the principal officers,—are not to be deemed in such possession and control of the properties as subjects them to garnishment."[170]

When the property of a corporation has been placed under the control of a receiver, he is the proper person upon whom service

[167] Brady v. Johnson, 75 Md. 445; 26 Atl. 49; 20 L. R. A. 737n.

[168] Wilder v. Shea, 76 Ky. 128, 137. See §§ 80–90.

[169] Wilder v. Shea, 76 Ky. 128, per Pryor, J.

[170] McGraw v. Memphis &c. R. Co. 5 Cold. (Tenn.) 434, 439. See §§ 80–90.

should be made to bring the corporation in as a garnishee or trustee of a defendant.[171]

§ 380. **Ordinarily a general creditor of a corporation may reach and apply to his debt moneys belonging to the corporation,** although it has given a mortgage of its property which expressly provides that it shall attach to the tolls and revenues of the corporation; for until the mortgagee takes possession the tolls and revenues do not belong to him, but remain in the control of the corporation. But where by statute the tolls of a canal company are appropriated to the payment of repairs, expenses, and a mortgage to the state, the application of the tolls and revenues is taken out of the disposal of the corporation; and a general creditor, having notice of the provisions of the statute and of the mortgage at the time of contracting his debt, will be restrained from levying on money deposited by the company in a bank, and needed for the purposes specified.[172]

[171] **Phelan v. Ganebin, 5 Colo. 14.**

[172] **Macalester v. Maryland, 114 U. S. 598; 5 Sup. Ct. 1065.**

CHAPTER XIII.

FORECLOSURE PROCEEDINGS UNDER CORPORATE MORTGAGES.

I. Default must be shown, §§ 381–385.
II. Parties plaintiff, §§ 386–397.
III. Parties defendant, §§ 398–413.
IV. Defences, §§ 414–416.
V. Decrees, §§ 417–424.

In the present chapter it is proposed to examine only such decisions as relate directly to the foreclosure of corporate mortgages. For general principles governing proceedings in equitable suits of foreclosure, determining the parties to such suits, the pleadings and the decrees, reference should be had, if there be occasion, to general treatises.[1]

I. *Default must be Shown.*

§ 381. A default within the terms of the mortgage must be set forth in the bill. It is necessary to allege and prove something more than the mere fact that interest coupons payable at certain times before the bringing of the bill have not been paid; for the simple circumstance of their non-payment is not inconsistent with the fact of the performance by the corporation of all its obligations. The allegation should show a default in some manner to fulfill the provisions of the mortgage; as, either that the company had neglected or refused to pay the coupons at the place and in the manner provided, or that the company had in some form been requested to pay them, and had neglected to comply with such request.[2]

[1] See Jones Mortgages, Chapters xxi., xxii. §§ 1367–1515.

[2] Davies v. New York &c. Co. 41 Hun (N. Y.), 492.

Where the mortgagee is in possession as lessee, the question whether there has been a default may depend upon a proper accounting by the lessee. Thus, where, after a mortgage was made by a railroad company of all its property and franchises, the company leased its road and all its property to another railroad company, for a term the same as that of the mortgage, the lessee, instead of paying rent, agreed to apply the net income from the use of the road to the payment of the interest on the mortgage, and afterwards became the owner of all the mortgage bonds. In a suit by the trustee to foreclose the mortgage, it was held that there had been no default in case the net receipts from the road had been sufficient to pay the interest; and that the lessee company, which was really the plaintiff, was bound to account for and apply the net receipts from the leased road, and could not estimate such receipts as being a pro rata part of the receipts from the entire mileage of the lessee company.[3]

§ 382. If the principal of the mortgage be not due, but interest is due and unpaid, there may be a decree of foreclosure in respect of this.[4] And the trustee may exercise an option given by the trust deed and declare the whole debt due upon a default in the payment of interest merely.[5] It has also been held that no formal declaration by the trustee of the maturity of the principal is necessary in such a case.[6]

In a foreclosure suit upon a general mortgage which contains a covenant by the company to pay the interest upon prior divisional mortgages, no decree can be granted in respect of a default in the payment of such interest, unless the plaintiff has paid it so that the interest is due to him. Except in such case the holders of the divisional mortgages, or the bondholders secured by them, can alone maintain an action for such interest.[7]

[3] Chamberlain v. Connecticut &c. R. Co. 54 Conn. 472; 9 Atl. 244.

[4] Union Trust Co. v. St. Louis &c. R. Co. 5 Dill. (U. S.) 1; Pennsylvania Co. v. Philadelphia &c. R. Co. 69 Fed. 482.

[5] New Memphis Gas Light Co. Cases, 105 Tenn. 268; 60 S. W. 206; 80 Am. St. 880.

[6] Morgan's Co. v. Texas Central R. Co. 137 U. S. 171; 11 Sup. Ct. 61.

[7] Union Trust Co. v. St. Louis &c. R. Co. 5 Dill. (U. S.) 1.

A tender must be of all the interest due on bonds in order to arrest an action to foreclose the mortgage securing them.[8]

§ 382a. **In foreclosure for default in payment of interest** where no provision is made for earlier maturity of the principal debt, the general rule is that only so much of the property as may be necessary to raise the amount of the interest in default shall be sold.[9] But under a statute providing that where part of the mortgaged property cannot be sold without material injury, the whole may be sold together, an entire railway may be sold upon a partial foreclosure. The mortgage embracing road-bed, superstructure, and the franchise to operate a railroad, a moment's consideration forces the conclusion that the property and franchises are so essentially intermingled that they cannot be separated without material injury, if not entire destruction. So that the statute becomes a rule or procedure authorizing the sale of the whole of the mortgaged premises, although the principal is not due by the terms of the mortgage.[10]

§ 382b. **Upon failure to pay or discharge an execution levied or sued out,** it may be provided that a mortgage shall become enforceable, if the trustee declare the principal and interest upon the bonds to be immediately payable. That the execution be sued out on a judgment by a bondholder upon interest coupons, in a suit which was allowed to go by default for the express purpose of maturing the mortgage, does not constitute fraudulent collusion. The fact that the action is taken for the purpose of enabling the trustee to declare the principal and interest due does not invalidate the proceeding so long as there is a debt due, an action properly conducted to recover it, and the object to be gained is not an illegal one. If the law concerned itself with the motives of parties new complications would be introduced into suits which might seriously obscure their real merits.[11] A requirement that the execution shall be "forthwith"

[8] Van Benthuysen v. Central &c. R. Co. 63 Hun (N. Y.), 627; 17 N. Y. S. 709.

[9] 2 Jones Mort. § 1577.

[10] McFadden v. Mays Landing &c. R. Co. 49 N. J. Eq. 176; 22 Atl. 932.

[11] Dickerman v. Northern Trust Co. 176 U. S. 181; 20 Sup. Ct. 311.

paid means that it should be paid as soon as it could be by reasonable exertion.[12]

§ 382c. **Failure to reimburse a fund out of which interest is payable** in case of default by the corporation is a ground for instituting foreclosure proceedings, such reimbursement being made obligatory upon the corporation within a year. The trustee, having made two interest payments out of the fund, which were not restored, is justified in foreclosing the security it holds for the bondholders, and is not bound to wait until the fund is exhausted.[13]

§ 383. **A demand of the interest payable may be necessary under the trust deed to constitute a default** which will authorize a sale under the power, or by foreclosure suit. Thus where a trust deed provided that, on default "after demand" for a period of six months, the trustee might sell the property; and it was further provided that, "in the event of any default in the payment of interest which shall continue for a period of six months, the whole principal shall become due," it was held a default in the payment of interest could be predicated only upon refusal to pay after a demand had been made, and that such default must continue for the period named before an action could be commenced to foreclose the mortgage. The word "default" in the latter clause was regarded as being used in the sense in which it was first used; that is, a default after a demand.[14]

If the mortgagee knows that the mortgagor has the money ready at its usual place of payment, though not at the place named in the mortgage, and he requires payment at the place so named, he should notify the mortgagor to this effect; and if he does not, and he refuses to receive payment at the usual place except on conditions, he waives the right to payment elsewhere, and cannot, on a default so made, treat the whole debt as due.[15]

A default may be waived so that no right of action will arise by reason of non-payment upon the day stipulated. If the waiver be

[12] Dickerman v. Northern Trust Co. 176 U. S. 181; 20 Sup. Ct. 311.

[13] Land Title &c. Co. v. National Asphalt Co. 127 Fed. 1.

[14] Potomac Mfg. Co. v. Evans, 84 Va. 717; 6 S. E. 2.

[15] Union Mut. &c. Co. v. Union Mills &c. Co. 37 Fed. 286.

by parol and without consideration, it may be revoked, and then, after a demand of payment, the payment waived will become due.[16]

§ 384. **Corporation mortgages generally provide that a default shall have continued for a period named** before any right to enforce the mortgage accrues. Where it is provided that a power of sale may be exercised by the mortgage trustees in case of a continued default for sixty days after notice to the mortgagor of an intention to sell, but not until the sale has been previously advertised for sixty days, there is in the first place no default authorizing a sale until the lapse of sixty days after notice to the mortgagor of intention to sell, and then the sale must be advertised for sixty days before sale. The two powers are not synchronous, but successive.[17] A provision that foreclosure shall not take place until ninety days' notice has been given by publication does not apply to the bringing of a suit for foreclosure, but to the foreclosure itself.[18]

§ 385. **An action to foreclose a mortgage may be brought immediately upon a default** in the payment of either the interest or the principal debt, although the mortgage contains a provision that, after default in the payment of the principal or interest continued for a period named, the trustee may enter into possession of the property and sell it upon giving a specified notice of the time and place of sale. This clause is designed to affect and qualify only the right of entry, possession, and power of sale, not to prevent an action to collect the debt and appropriate the security to its payment.[19]

[16] Albert v. Grosvenor &c. Co. L. R. 3 Q. B. 123; Union Trust Co. v. St. Louis &c. R. Co. 5 Dill. (U. S.) 1.

[17] Macon &c. R. Co. v. Georgia R. Co. 63 Ga. 103.

[18] Hodder v. Kentucky &c. R. Co. 7 Fed. 793.

[19] Central Trust Co. v. New York &c. R. Co. 33 Hun (N. Y.), 513; Chicago &c. R. Co. v. Fosdick, 106 U. S. 47; 1 Sup. Ct. 10; Mercantile Trust Co. v. Missouri &c. R. Co. 36 Fed. 221; 36 Am. & Eng. R. Cas. 259; Central Trust Co. v. Texas &c. R. Co. 23 Fed. 846; McFadden v. Mays Landing &c. R. Co. 49 N. J. Eq. 176; 22 Atl. 932; Guaranty &c. Co. v. Green Cove &c. Co. 139 U. S. 137; 11 Sup. Ct. 512; Farmers' &c. Co. v. Winona &c. R. Co. 59 Fed. 957; Mercantile Trust Co. v. Chicago &c. R. Co. 61 Fed. 372; Farmers' &c. Co. v. Chicago &c. R. Co. 61 Fed. 543.

One reason for limiting the resort to proceedings for a sale under a power, while not limiting a resort to proceedings to foreclose in a court of equity, is, that a sale under a power is speedy and summary, and wrong might be done by putting it within the power of a single bondholder or coupon holder to institute proceedings for the sale of the property under the power upon the happening of a temporary default. But proceedings in a court of equity are not thus hasty. They are not within the control of any coupon holder or any trustee, but within the control of the court.[20]

A provision prohibiting the trustee, without the consent of a majority of the bondholders, to take possession or sell or to maintain a foreclosure suit for the principal of the bonds before their maturity, does not abrogate the right of the trustee, at the request of a single bondholder, to foreclose the mortgage upon a default in the payment of interest.[21]

II. *Parties Plaintiff.*

§ 386. **The mortgage trustee, although he does not himself own any part of the mortgage debt,** the mortgage being in fact made to him as trustee for the benefit of the holders of certain notes, but not expressing the trust upon its face, is the proper party to enforce it by foreclosure suit.[22] He not only holds the legal title, under which he could maintain an action to recover possession of the property mortgaged upon condition broken, but by his relation to the holders

[20] Mercantile Trust Co. v. Missouri &c. R. Co. 36 Fed. 221, per Brewer, J.

[21] Farmers' &c. Co. v. Chicago &c. R. Co. 27 Fed. 146.

Power to a majority of bondholders to waive default will not bind a minority when the action of the majority is collusive. Hackettstown Nat. Bank v. D. G. Yuengling &c. Co. 74 Fed. 110; Linder v. Hartwell R. Co. 73 Fed. 320.

[22] Hays v. Galion &c. Co. 29 Ohio St. 330; Coe v. Columbus &c. R. Co. 10 Ohio St. 372; 15 Am. Dec. 518n; Savannah &c. R. Co. v. Lancaster, 62 Ala. 555; Boston &c. R. Co. v. Coffin, 50 Conn. 150; Hale v. Nashua &c. R. Co. 60 N. H. 333; Henry v. Travellers' Ins. Co. 16 Colo. 179; 26 Pac. 318. As to the consent of bondholders to a foreclosure suit under a statute requiring such consent, see Barnes v. Chicago &c. R. Co. 122 U. S. 1; 7 Sup. Ct. 1043; Atlantic Trust Co. v. Crystal Water Co. 72 N. Y. App. Div. 539; 76 N. Y. S. 647, citing text.

of the notes he is a trustee, presumptively clothed with the requisite power to act for them in the collection of the debt. Whether such holders be numerous or not, he may bring suit to enforce the security without uniting those for whose benefit it is prosecuted.[23]

Upon the death of a mortgage trustee, the right of action is in his successor duly appointed; and though the mortgage was to the trustee named in the mortgage, his heirs and assigns, the heir at law cannot be made a party to the action as against a duly appointed successor in the trust.[24]

§ 387. **If there are two or more mortgage trustees they should join in the foreclosure suit,** though one trustee might, upon a default, maintain the action if the other refused to act, in which case the other trustee should be made a party defendant.[25]

If, however, one trustee brings a foreclosure suit upon the request of a small minority of the bondholders, and the other trustee, representing the great majority of the bondholders, asks for a stay of proceedings, offering to pay up any of the bonds secured by the mortgage that might be offered for payment, together with the costs of the foreclosure suit, such trustee and the majority of the bondholders are entitled to the relief sought. No independent action to obtain such relief is necessary. The bondholders have no right other than the right to receive payment in full. The co-beneficiaries in the mortgage who do not desire a foreclosure are entitled, upon paying the claims of those who seek a foreclosure, to be subrogated to their rights under the mortgage, or to an assignment of the bonds paid.[26]

§ 388. **A single bondholder, unless restrained by the terms of the mortgage, may maintain a bill in equity to foreclose a mortgage,** bringing it in his own name, but for the benefit of all other bondholders as well as of himself. In this respect it makes no difference whether the bondholder is secured by a mortgage deed strictly such, where the mortgagee holds the title in trust for the holders of such of the bonds as he has transferred, or whether he is secured by a

[23] Chicago &c. R. Land Co. v. Peck, 112 Ill. 408.

[24] Gibbes v. Greenville &c. R. Co. 13 S. C. 228.

[25] Tillinghast v. Troy &c. R. Co. 48 Hun (N. Y.), 420; 1 N. Y. S. 243.

[26] Tillinghast v. Troy & B. R. Co. 48 Hun (N. Y.), 420; 1 N. Y. S. 243.

trust deed in the usual form, where a trustee holds the title for the benefit of all the bondholders.[27]

A foreclosure suit brought by a bondholder for himself and all others enures to the benefit of all, and prevents the running of the statute of limitations as to all. Other bondholders who choose to be made plaintiffs in the suit may come in on petition, in the discretion of the court, even after the suit has been pending several terms.[28] Bondholders and holders of coupons, who refuse to unite with the complainant in the prosecution of the suit, may be joined as respondents.[29]

Ordinarily a bondholder secured by a mortgage to trustees is not allowed to sue the corporation with respect to any matter within the trust, except when it appears that the trustees refuse or neglect to act, or they stand in a hostile position, or have assumed a position prejudicial to the interests of the bondholders, or there is a vacancy in the office.[30] Such neglect, refusal, or vacancy he must allege and prove.[31] Especially is this true when the apparent object of having the bondholder sue in place of the trustee is to give jurisdiction to a federal court.

[27] Mason v. York &c. R. Co. 52 Me. 82; March v. Eastern R. Co. 40 N. H. 548, 566; 77 Am. Dec. 732; Carpenter v. Canal Co. 35 Ohio St. 307; Commonwealth v. Susquehanna &c. R. Co. 122 Pa. St. 306; 15 Atl. 448; 1 L. R. A. 225; Brooks v. Vermont &c. R. Co. 14 Blatchf. (U. S.) 463; Mercantile Trust Co. v. Lamoille &c. R. Co. 16 Blatchf. (U. S.) 324; 2 Jones Mortg. § 1385. Where default has been made only on the bonds held by complainant, an averment that the suit is brought in behalf of all bondholders is unnecessary. McFadden v. Mays Landing &c. R. Co. 49 N. J. Eq. 176; 22 Atl. 932.

[28] Campbell v. Railroad Co. 1 Woods (U. S.), 368, 376; Smith v. Rutland R. Co. 56 Vt. 82; 33 Am. & Eng. R. Cas. 646.

[29] Hotel Co. v. Wade, 97 U. S. 13.

[30] Knapp v. Railroad Co. 20 Wall. (U. S.) 117; Coal Co. v. Blatchford, 11 Wall. (U. S.) 172, 177; Galveston R. Co. v. Cowdrey, 11 Wall. (U. S.) 459, 478; Campbell v. Railroad Co. 1 Woods (U. S.) 35; Webb v. Vermont &c. R. Co. 20 Blatchf. (U. S.) 218; Davies v. New York &c. R. Co. 41 Hun (N. Y.), 492, 497; Weetjen v. St. Paul &c. R. Co. 4 Hun (N. Y.), 529; Weetjen v. Vibbard, 5 Hun (N. Y.), 265; Greaves v. Gouge, 69 N. Y. 154; Brinckerhoff v. Bostwick, 88 N. Y. 52, 56; Commonwealth v. Susquehanna &c. R. Co. 122 Pa. St. 306; 15 Atl. 448; 1 L. R. A. 225; Credit Co. v. Arkansas &c. R. Co. 5 McCrary (U. S.), 23; Chicago &c. R. Co. v. Fosdick, 106 U. S. 47; 1 Sup. Ct. 10.

[31] Morgan v. Kansas &c. R. Co. 15 Fed. 55; Needham v. Wilson, 47 Fed. 97.

A notice by a bondholder to the mortgage trustee of a default in the payment of coupons, and a request to him to foreclose the mortgage on that account, not complied with, are ground for an action of foreclosure by the bondholder himself only for such default, and are no ground for an action by him alleging that the corporation had neglected to perform a covenant in the mortgage to pay all taxes and assessments imposed by law upon the mortgaged premises. The mortgage trustee is not in such case in default for failing to institute a foreclosure for breach of the covenant to pay taxes and assessments, and if he is in default the bondholder has no right to institute a proceeding to foreclose for that failure on the part of the corporation.[32]

After a mortgage trustee has sued for a foreclosure, and by a supplemental bill has asked that a plan of reorganization be established, a single litigating bondholder, who objects to such plan, cannot proceed with a bill of foreclosure as an independent measure, but must come into the trustee's suit already pending for the protection of any rights or equities he has.[33]

A bondholder who brings a suit upon bonds of which others are joint owners with him, must join his co-owners as complainants.[34]

§ 389. **A single bondholder may insist upon a foreclosure although the mortgage provides for a sale by the trustee upon request of the majority of the bondholders** secured by the mortgage. Inasmuch as a provision in a railroad mortgage authorizing the trustee, on the company's default, to take possession of the property, and upon notice to sell it, is a cumulative remedy which does not affect the right to foreclose by bill in equity, a provision in the deed authorizing the trustee, upon request of a majority of the holders of bonds, to exercise the power, does not in any way affect the right of a single bondholder, upon default of the company, to insist upon a foreclosure in equity, at least for the amount of the interest overdue, if the whole principal debt has not become due by lapse of time, or by virtue of any provision of the mortgage.[35] This point

[32] Davies v. New York &c. Co. 41 Hun (N. Y.), 492, 497.

[33] Stern v. Wisconsin &c. R. Co. 1 Fed. 555.

[34] Messchaert v. Kennedy, 4 McCrary (U. S.), 133.

[35] First Nat. Ins. Co. v. Salisbury, 130 Mass. 303.

is illustrated by the case of Alexander v. Central Railroad of Iowa,[36] before the Circuit Court of the United States for the District of Iowa. This company had executed a mortgage containing a provision: "And it is agreed, in case of the default of the payment of the interest, that the trustee is expressly authorized and empowered, *upon the request in writing of a majority* of the owners or holders of said bonds, to enter into and upon, and to take actual possession of all the mortgaged property, and to sell the same." And it was further provided that in case the company should make default in the payment of interest, then, after the expiration of twelve months from the time it became due, and without demand or notice, at the election or option of a majority of the holders of said bonds, the whole principal sum mentioned in the said mortgage bonds then outstanding should forthwith become due and payable.

A default having occurred in the payment of interest, certain bondholders requested the mortgage trustee, a trust company, to bring a suit to foreclose the mortgage, and upon its refusal so to do they themselves filed a bill in equity for that purpose in their own behalf, and for all other bondholders who might be similarly situated, to which the trustee was made a party defendant. The trustee appeared and filed an answer, setting up that a majority of the bondholders had never demanded action on the part of the trustee, and that it was willing to submit to the direction of the court as to its duty in the premises, and to become plaintiff if the court should so order. The railroad company demurred to the bill, on the ground that under the provision of the deed of trust there could be no foreclosure by bondholders, or by the trustee, unless a majority of the bondholders so desired, and there was no such averment in the bill. The court, however, held that the bill was properly brought; but if the plaintiffs elected to dismiss the bill as to the trustee, the latter might be allowed to become a party plaintiff, and to file a bill for the benefit of all the bondholders. The provisions of the mortgage deed did not restrict the right of any coupon holder to foreclose for interest after a default for the requisite time. By the terms of the mortgage the whole principal would not become due upon a default

[36] 3 Dill. (U. S.) 487; 1 Cent. L. J. 543. See, also, relating to the same case, Farmers' &c. Co. v. Central R. 4 Dill. (U. S.) 533; 5 Cent. L. J. 56; Sage v. Central R. Co. 93 U. S. 412.

in the payment of interest, except at the election of a majority of the holders of the bonds; and so, therefore, with such action on the part of the bondholders, there could be no foreclosure in equity for anything more than the overdue interest. But to this extent any one of the bondholders could invoke the remedy in equity to foreclose.

§ 390. **A holder of bonds payable to bearer is an original payee,** who may maintain a bill in equity in his own name for the benefit of himself and others. Such a holder is not merely an assignee, but is a payee to whom the promise runs directly.[37]

§ 391. **When trustees for bondholders have received money applicable to the payment of the bonds,** each bondholder at that time becomes immediately entitled to the share of the money applicable to his bonds, and can immediately recover the same to himself. If nothing is involved but the recovery of the money, the right of each bondholder to the share of the money belonging to him would be several, and the suits would necessarily be separate, and probably at law rather than in equity. But in case the money accruing to the bondholders has remained in the hands of the trustee for a long time, and the mortgaged property itself is involved, all the bondholders have a common interest in the property, and no one of them has a separate right exclusive of the others; and therefore in such case the proceedings to reach and apply the property should be in equity in behalf of all the bondholders.[38]

The question whether bondholders who have acquired their bonds since the money in the hands of the trustees became applicable to the bonds are entitled to share in that money, depends upon the nature of the right, and of the transaction by which they acquired the bonds; but as a rule, when bonds are transferred, the security, whatever it is, passes also, so that the time when holders acquired their bonds is not ordinarily material.[39]

[37] Rutten v. Union Pac. R. Co. 17 Fed. 480; White v. Vermont &c. R. Co. 21 How. (U. S.) 575. This is to be distinguished from cases where the holder is an equitable assignee of a purely legal right of action, such as Hayward v. Andrews, 106 U. S. 672; 1 Sup. Ct. Rep. 544; New York &c. Co. v. Memphis Water Co. 107 U. S. 205; 2 Sup. Ct. 279.

[38] Dwight v. Smith, 13 Fed. 50

[39] Dwight v. Smith, 13 Fed. 50. The court remark in this case that

§ 392. It is not necessary that all the bondholders should actually join in the suit. When a foreclosure suit has been commenced by bondholders in behalf of themselves and all other bondholders whose bonds are secured by the same deed, who choose to come in as complainants and bear their share of the expenses of the suit, and the trustees of the mortgage are made defendants, it is not necessary that all the bondholders shall be made actual parties, especially when they are numerous, and many of them unknown.[40] To require all of them to be made parties, and in the case of the death of any that the suit should be revived in the name of the personal representative of the deceased party, before any final decree could be rendered, would be to deny the bondholders any relief. The rule and practice of courts of equity in such cases is that the case may proceed when the court has sufficient parties before it to represent all the adverse interests of the plaintiffs and defendants. The interests of the bondholders are represented by the actual complainants, and by the trustees who are made parties defendant. The other bondholders may be allowed to come in as complainants,[41] or may propound their claims before the master, without making themselves parties to the suit.[42] Still in an exceptional case where several questions were involved, all the bondholders were necessary parties, and it was held they should all be made parties plaintiff.[43]

A holder of part of the bonds, secured by a mortgage of property insufficient to satisfy the entire mortgage debt, has no right to appropriate to his sole benefit, by execution and sale, the property mortgaged to secure all the bonds. The bondholders have a common interest in the security, and are all equally entitled to the benefit of it; and in case of a deficiency of the fund to satisfy the whole of the debt, a distribution must be made in equity among all the hold-

the time when the bonds were acquired is not so material as was supposed and held in Dwight v. Smith, 9 Fed. 795.

[40] Mason v. York &c. R. Co. 52 Me. 82; March v. Eastern R. Co. 40 N. H. 548, 566; 77 Am. Dec. 732; Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 447; Campbell v. Railroad Co. 1 Woods (U. S.), 368; Atlantic Trust Co. v. Crystal Water Co. 72 App. Div. (N. Y.) 539; 76 N. Y. S. 647.

[41] Chickering, In re, 56 Vt. 82.

[42] Jones Mortgages, § 1385; First Nat. Ins. Co. v. Salisbury, 130 Mass. 303; Hackensack Water Co. v. DeKay, 36 N. J. Eq. 548.

[43] Mangels v. Danau Brewing Co. 53 Fed. 513.

ers of bonds pro rata.[44] To permit a bondholder to proceed at law for the collection of a part of the mortgage debt by execution against the mortgaged property would prevent a pro rata distribution in case of a deficiency, and would give him an inequitable preference over his fellow-bondholders.[45]

A single bondholder cannot attach and apply to the payment of his claim any part of the property mortgaged to pay his own bonds and others secured by the mortgage without alleging and proving that the other debts secured by the mortgage have been paid, and bringing the mortgage trustees or other holders of the legal title before the court.[46]

Other owners of bonds may on petition, in the discretion of the court, be made parties plaintiff in a foreclosure suit brought by a part of the bondholders in behalf of themselves and all other bondholders who might choose to come into the suit.[47]

§ 393. A single bondholder cannot reach the property conveyed to the trustee, by a suit to enforce his individual claim. The remedy against the property conveyed to the trustee is through him, or through a bondholder acting for all the bondholders. As to other property of the corporation not conveyed to the trustee, the bondholder has the same right as any individual creditor to levy upon it. His execution cannot be levied upon property not actually owned by the company, but conveyed to trustees by a mortgage duly recorded. If he levies upon and sells the mortgaged property and franchises of the corporation under a judgment for the principal or interest of his bonds, the purchaser acquires no title to such property and franchises.[48]

§ 394. One who holds bonds of a railroad company as collateral

[44] Pennock v. Coe, 23 How. (U. S.) 117; Commonwealth v. Susquehanna &c. R. Co. 122 Pa. St. 306; 15 Atl. 488; 1 L. R. A. 225.

[45] Fish v. N. Y. Water-Proof Paper Co. 29 N. J. Eq. 16.

[46] Martin v. Mobile & O. R. Co. 7 Bush (Ky.), 116.

[47] Chickering, In re, 56 Vt. 82.

[48] Commonwealth v. Susquehanna &c. R. Co. 122 Pa. St. 306; 15 Atl. 448; 1 L. R. A. 225; Philadelphia &c. R. Co. v. Woelpper, 64 Pa. St. 366; 3 Am. R. 596; Bradley v. Chester &c. R. Co. 36 Pa. St. 141; Philadelphia &c. R. Co. v. Johnson, 54 Pa. St. 127; Hackensack &c. Co. v. DeKay, 36 N. J. Eq. 548.

security has the same right as any other bondholder to press a sale of the mortgaged property.[49] The cooperation of a pledgee of bonds with other bondholders in the foreclosure of the mortgage, by his assent that his proportionate share of the expenses thereof may be a lien upon the bonds, and that the trustee may apply the bonds in payment at the foreclosure sale, does not constitute a conversion of the bonds by such pledgee.[50]

To a suit by bondholders to foreclose a mortgage, the mortgagor may plead that the complainants are not the absolute owners of the bonds, but hold them as collateral security for a debt less in amount than the money due on the bonds, and that the assignor should be made a party to the bill.[51]

In a suit against a railroad company by the pledgees of its bonds as collateral security for its own indebtedness to a smaller amount, a decree can be entered for only the amount secured by the pledge.[52]

§ 395. After individual bondholders have filed a bill to foreclose a mortgage in behalf of themselves and all others in like interest, the trustees to whom the mortgage was made may come in and ask to become complainants instead of defendants, and their request will generally be allowed, unless it appears that they have adverse interests, and are not in good faith fulfilling their trust. So soon as they are admitted as complainants, however, they have control of the suit, and are charged with the conduct of it. The only standing the original complainants, the bondholders, have, must arise from an allegation that the trustees were derelict in their duty; or from some like allegation showing the neglect or refusal of the trustees to act. When the trustees come into court, deny the charge of neglect or unfaithfulness, and ask to do what the bondholders allege they ought to do, but were unwilling or neglected to do, and are allowed to become complainants, they then become masters of the suit.[53]

[49] McCurdy's Appeal, 65 Pa. St. 290; Morton v. New Orleans &c. R. Co. 79 Ala. 590; Gilman v. New Orleans &c. R. Co. 72 Ala. 566; Illinois &c. Bank v. Pacific R. Co. 117 Cal. 332; 49 Pac. 197; 5 Am. St. 442, citing text.

[50] Field v. Sibley, 74 App. Div. (N. Y.) 81; 77 N. Y. S. 252.

[51] Ackerson v. Lodi Branch R. Co. 28 N. J. Eq. 542.

[52] Jesup v. City Bank, 14 Wis. 331.

[53] Richards v. Chesapeake &c. R. Co. 1 Hughes (U. S.), 28. See, also,

The trustees in such case may be allowed, in the discretion of the court, to dismiss the proceedings commenced by the bondholders and proceed in another court. Thus a bill to foreclose a mortgage made by the Chesapeake and Ohio Railroad Company, brought by bondholders in the Circuit Court of the United States for the Eastern District of Virginia,[54] was dismissed at the request of the trustees, who had subsequently been admitted as complainants, in order that they might be allowed to proceed in the courts of the State of Virginia, in which they had commenced proceedings, and where, as they alleged, certain difficulties in regard to jurisdiction which arose in the Circuit Court would not be in the way of their proceedings, and where they would have other advantages in prosecuting the suit. All the bondholders under the mortgage acquiescing in their request, with the exception of a few holding a comparatively small amount, the Circuit Court declared that for the court to determine that the trustees should proceed in that court and not elsewhere, there being no charge of duplicity or fraud on their part, would be to set up the opinion of the court as to what the best interests of these *cestuis que trustent* are against those of themselves and of the trustees who are legally charged with the care of those interests. The objection to the original bill in this case being in large part on account of the absence of proper parties, the bondholders who objected to the dismissal of the bill asked leave, if the court should allow the motion to dismiss, to file a new bill, which should include all the proper parties, and should relate back to the time of the filing of the original bill. "A fatal objection to this request," said Judge Bond, "is that, now that the trustees have undertaken by legal means to foreclose this mortgage, no bondholder has a right to proceed in his own name to foreclose. He can ask the aid of a court of equity only on the ground of unfaithfulness, neglect, or inability on the part of the trustees.

"Upon due consideration, therefore, the court will make an order directing the receiver to settle his accounts up to a day named therein, and to make a report thereof to the court up to that date, whereupon he will be discharged, and the complainants be allowed to dis-

Farmers' &c. Co. v. Central R. Co. 67 Ia. 136; 24 N. W. 895; 11 West. Jurist, 428.

[54] Richards v. Chesapeake &c. R. Co. 1 Hughes (U. S.), 28.

miss their proceedings and prosecute those already commenced in the state court." In this opinion Chief Justice Waite concurred.

§ 396. **When a railroad company mortgages its property directly to all its bondholders by name,** to secure specifically to each the amount due on the bonds to him, no one bondholder, even when professing to act in behalf of all bondholders who come in and contribute to the expenses of the suit, can proceed alone against the company, and ask a sale of the property. It is a general rule, both at law and in equity, that a suit upon a written instrument must be brought in the name of all persons who are parties to it or have an interest in it. Then, if it appears that the mortgage is an inadequate security, there is another reason why one bondholder or a part of the bondholders cannot proceed without the others. In such case it is the interest of every bondholder to diminish the claim of every other bondholder. "In so far as he succeeds in doing that, he adds to his own security. Each holder, therefore, should be present, both that he may defend his own claims and that he may attack the other claims should there be occasion for it. If, upon a fair adjustment of the amount of the debts, there should be a deficiency in the security, real or apprehended, every one interested should have notice in advance of the time, place, and mode of sale, that he may make timely arrangements to secure a sale of the property at its full value."[55]

§ 397. **A suit by trustees or a part of the bondholders to foreclose a mortgage prevents the running of the statue of limitations as to all the bondholders.** Whatever the trustees or one or more of the bondholders do in behalf of all, for the enforcement of the common security, enures to the benefit of all. It is not necessary that each individual bondholder should bring a suit in his own name to enforce the mortgage to prevent the effect of the lapse of time on his right to enforce it.[56]

[55] Railroad Co. v. Orr, 18 Wall. (U. S.) 471, 475.

[56] Chickering, In re, 56 Vt. 82.

III. *Parties Defendant.*

§ 398. The bondholders for whose benefit a mortgage of the property and franchises of a railroad company has been made to trustees are not generally necessary or proper parties to a bill in equity brought by the trustees against the company to foreclose the mortgage.[57]

A trustee for bondholders represents their interests, and when made a party to a suit affecting their interests, they are as much bound by the decree rendered in the suit as if they were individually made parties to the suit. If a trustee, who is made a party to the suit, is himself a bondholder, he cannot afterwards litigate the same subject-matter in his individual capacity. If he owned the bonds at the time, he is bound because he was representing himself. If he has bought them since the suit, he is bound as privy to the person who was represented.[58]

Individual bondholders will not be made parties to the suit unless they allege some malfeasance or incompetency on the part of the trustee.[59] The fact that the trustees have approved a plan of re-

[57] Shaw v. Norfolk County R. Co. 5 Gray (Mass.), 162; Atlantic &c. R. Co. In re, 3 Hughes (U. S.), 320; Wetmore v. St. Paul &c. R. Co. 1 McCrary (U. S.), 466; Vose v. Bronson 6 Wall. (U. S.) 452; Chicago &c. R. Co. v. Howard, 7 Wall. (U. S.) 392; Shaw v. Little Rock &c. R. Co. 100 U. S. 605; Clyde v. Richmond &c. R. Co. 55 Fed. 445, citing text. In Pennsylvania, however, it is held that, in a proceeding attacking the validity of a mortgage and the bonds, bondholders are necessary parties to a suit brought to adjudge void a mortgage, and the bonds secured thereby, given by a corporation; and that service on the trustees alone is not sufficient to bind the bondholders. The trustees are regarded as merely custodians of the legal title for the benefit of the bondholders; and it is declared that there is nothing in that relation which makes the trustees general agents for the bondholders as to all matters affecting the bonds. Harrisburg & E. R. R. Co.'s App. 36 Am. & Eng. R. Cas. 249. Where bondholders are allowed to intervene, the death of one of their class will not cause the suit to abate, nor is it necessary to have the personal representative made a party. Weed v. Gainsville &c. R. Co. 119 Ga. 576; 46 S. E. 885.

[58] Corcoran v. Chesapeake &c. Co. 94 U. S. 741.

[59] Atlantic &c. R. Co. In re, 3 Hughes (U. S.), 320; 3 Hughes, 320; Farmers' &c. Co. v. Kansas City &c. R. Co. 53 Fed. 182. A holder of part of the bonds will not be

organization proposed by one set of bondholders is no ground for allowing another set to become parties to the suit. But if in such case one set of bondholders alleges that the trustee had espoused the interests of those supporting a plan of reorganization, and that improper compensation and extravagant amounts for expenditures had been allowed to the receiver, these objecting bondholders should be allowed to become parties so far as to permit an examination of these charges.[60]

A bondholder is not a necessary party whether the mortgage constitutes a prior or subsequent incumbrance, or whether the trustees be complainants or defendants in the suit. A bondholder is a privy in interest, and may come in to defend *pro interesse suo,* but his rights are affected by a decree against a trustee. He does not stand in the attitude of a stranger claiming collaterally, but comes in under the mortgage.[61]

Bondholders are not permitted to intervene for the purpose of litigating questions with a voluntary committee of bondholders, formed to reorganize the corporation. Neither such committee nor its members are parties to the suit, and the court has no power to make them parties for the purpose of controlling their actions in regard to such reorganization.[62]

Bondholders having another remedy under a local corporation law are not allowed to intervene for the purpose of objecting to the appointment of particular receivers.[63]

§ 398a. As a general rule the trustee of a railroad mortgage represents all the bondholders, and his acts bind them if done in

permitted to intervene in a foreclosure suit before decree for sale for the mere purpose of litigating a claim to priority over other bondholders; that being a question which can be litigated before the master on application for distribution of the proceeds. Mercantile Trust Co. v. United States &c. Co. 130 Fed. 725. So where the corporation itself is a defendant. Ferris, In re, 15 Atl. 751.

[60] De Betz's Petition, 9 Abb. N. C. (N. Y.) 246. To similar effect see Henry v. Travellers' Ins. Co. 16 Colo. 179; 26 Pac. 318, and Gasquet v. Fidelity &c. Co. 57 Fed. 80.

[61] Iowa County v. Mineral Point R. Co. 24 Wis. 93; McElrath v. Pittsburgh &c. R. Co. 68 Pa. St. 37; Campbell v. Railroad Co. 1 Woods (U. S.), 368.

[62] Land Title &c. Co. v. Asphalt Co. 121 Fed. 587.

[63] Land Title &c. Co. v. Asphalt Co. 114 Fed. 484.

good faith.[64] And when differences of opinion exist between the bondholders, it is not improper that he should be governed by the voice of the majority, acting in good faith and without collusion, if what they ask is not inconsistent with the provisions of the trust.[65] But this decision of the trustee is not final. It is reviewable by the court, and in such review the objecting bondholders have the right to be heard in their own behalf. This follows as a corollary. The principle is that when, for any reason, the trustee cannot fully represent him, the bondholder can himself be heard on his own behalf. Having proved his bonds, he is already a *quasi* party; that is to say, with a voice in the cause, although not on the record. When he shows a cause of complaint, he has the right to be put in the record, so that a complete relief can be given for or against him.[66]

Where a trustee represents conflicting mortgages, the court will permit representatives of the bondholders of the various mortgages to be made parties to a foreclosure suit to the end that each set of bondholders may be represented by some one whose single object is to get all to which they are entitled.[67]

§ 399. A state which has indorsed the bonds of a railroad company, and has a statutory lien upon the property of the company for their payment, has an interest in a suit instituted by the holders of such bonds praying that they may be subrogated to the lien and rights of the state, and that the lien be established, and should be made a party if possible. But the fact that the state cannot be made a party is a sufficient reason for excusing her absence from the suit.[68] If the suit be in the Circuit Court of the United States within the state interested, and against a corporation organized under the laws of that state, while it is impossible to make the state a defendant, she cannot even by her own consent be made a party complainant, for that would oust the jurisdiction of the court.[69]

[64] Richter v. Jerome, 123 U. S. 246; 8 Sup. Ct. 106.

[65] First Nat. Bank v. Shedd, 121 U. S. 74, 86; 7 Sup. Ct. 807.

[66] Williams v. Morgan, 111 U. S. 684; 4 Sup. Ct. 638; Farmers' &c. Co. v. Cape Fear &c. R. Co. 71 Fed. 38; Toler v. East Tenn. &c. R. Co. 67 Fed. 168.

[67] Farmers' &c. Co. v. Northern Pac. R. Co. 70 Fed. 423; 66 Fed. 169; disapproving Clyde v. Railroad Co. 55 Fed. 445.

[68] Davis v. Gray, 16 Wall. (U. S.) 203, 220.

[69] Young v. Montgomery &c. R. Co. 2 Woods (U. S.), 606, 613.

"Suppose," said Judge Woods, "we turn the complainants out of this court because the state is not a party. If they go into the state court, they are met by the same difficulty, for the state will not allow herself to be sued in her own courts. Can it be possible that these complainants are without remedy against the railroad company because their bonds are indorsed by the plighted faith of the State of Alabama? It would be a reproach to the administration of justice to so hold." The complainants do not ask any relief against the state, but only a decree against the railroad company for the unpaid interest upon the bonds, and for a sale of the property pledged as security. Although the state is interested in having the property fairly applied to the extinguishment of the security, there is no reason why she must necessarily be made a party to a suit in which no decree is sought against her. "The indorser of a note secured by a mortgage is not a necessary party to a suit to foreclose the mortgage. If the state has paid any interest on these bonds, and is thereby entitled to any part of the proceeds of the mortgaged property, she can propound her claim before the master, and it will be allowed." Neither is the fact that the state cannot be sued any reason why the holders of the bonds should not be subrogated to the rights of the state and have the benefit of the security. Subrogation is an equitable principle, and is resorted to in order to prevent a failure of justice.

§ 399a. State aid bonds issued to assist in the construction of a railway and indorsed by the railway company do not thereby become a lien on the property or revenues of the company, and consequently neither the state nor holders of the bonds are necessary parties to a suit of foreclosure upon a subsequent mortgage given by the railway company upon its road and equipment.[70]

§ 399b. Partial payment of a bonded debt by a surety does not make him an indispensable or even a proper party to a suit foreclosing the mortgage given to secure the bonds. Payment of the whole debt for which the surety is liable is essential for subrogation. The equity of subrogation does not arise from the mere obligation to

[70] McKittrick v. Arkansas Central R. Co. 152 U. S. 473; 14 Sup. Ct. 661.

pay; it springs alone from payment. The creditors' rights in the mortgage must be entirely divested before the surety can be substituted by operation of law and allowed to stand in the shoes of the creditor. A general declaration of the principles of subrogation in a deed will not be construed to place the surety on an equal basis with the creditor in respect to each partial payment made by the surety.[71]

§ 400. **Whether the United States can compulsorily be made a defendant** in a suit to foreclose a mortgage on a railway upon which it holds a lien or mortgage is an unsettled question;[72] though Mr. Justice Grier, in the Circuit Court of the United States, has held that a mortgagee may have an effectual decree of foreclosure where the United States is the owner of the equity of redemption, on a notice given in such manner as the court may prescribe, if the land be not held for government purposes.[73]

§ 400a. **A guarantor of mortgage bonds** of a railway who afterwards joins with the company in borrowing money with which to pay interest does not thereby become subrogated *pro tanto* to the rights of the mortgagee, so as to become an indispensable or even a proper party to a subsequent foreclosure suit. The principle involved is that subrogation does not take place until the payment of the whole debt for which the surety is liable.[74]

§ 401. **A subsequent mortgagee** not made a party to a bill to foreclose a prior mortgage is unaffected by a sale under a decree rendered in such suit, and consequently he cannot have an injunction to restrain such sale. He may redeem at any time by tendering the amount due; and if only the interest on the prior mortgage is due, he may redeem on tendering that.[75] The Jacksonville, Pensacola and Mobile Railroad Company issued bonds under the Internal Iprovement Act of the State of Florida, which the trustees of the fund guaranteed upon the condition provided by the act, that

[71] Columbia &c. Co. v. Kentucky Union R. Co. 60 Fed. 794.

[72] Meier v. Kansas &c. R. 4 Dill. (U. S.) 378.

[73] Elliot v. Van Voorst, 3 Wall. (U. S.) Jr. 299.

[74] Columbia &c. Co. v. Kentucky &c. R. Co. 60 Fed. 794.

[75] Memphis &c. R. Co. v. State, 37 Ark. 632.

the bonds should be a first lien on the road, and on the failure of the company to provide and pay the interest, and one per cent. per annum for sinking fund, it should be the duty of the trustees, after thirty days from default, to take possession of the road and property, and advertise and sell it to the highest bidder, and apply the proceeds to purchasing and cancelling outstanding bonds of the company, or incorporate them with the sinking fund. Default was made, and the trustees sold the railroad for a sum sufficient to retire the guaranteed bonds of the company; but the purchasers, after paying a portion of the purchase money with which a portion of these bonds were retired, managed to get a deed of the property, and evaded or failed to pay the balance. The holders of some of the outstanding bonds then brought a bill against the holders of the property on the equity of the vendor's lien, to compel the payment of the balance of the purchase money, and obtained a decree and execution. A holder of second mortgage bonds of the company, who was not made a party to either the suit to foreclose the lien of the guaranteed bonds, or to the suit by the holders of such bonds to obtain payment of the balance of the purchase money, filed a bill to enjoin the sale. He claimed among other things that the principal of the first mortgage bonds was not due at the time of the sale by the trustees of the improvement fund, and that the second mortgagees ought to have the privilege of redeeming; but as he was not injured by the sale already had, and could not be injured by the proposed sale, his prayer was denied.[76]

A subsequent mortgagee, though made a party to the bill, if the decree does not cut off his lien, may redeem from the foreclosure sale.[77]

§ 402. In a foreclosure suit by bondholders holding lands secured by a first mortgage on part of the road, and by a second mortgage on the rest, asking for an account of the earnings received from the different parts of the road, and for the appointment of a receiver, the trustees of the second mortgage are necessary parties.[78]

[76] Searles v. Jacksonville &c. R. Co. 2 Woods (U. S.), 621.

[77] Simmons v. Taylor, 38 Fed. 682.

[78] Mercantile Trust Co. v. Portland &c. R. Co. 10 Fed. 604.

To a suit by bondholders under a first mortgage to compel the mortgage trustees to take possession of the mortgaged property, bondholders under a second mortgage to the same trustees are not necessary parties. The trustees have no adverse interest, and they are the fittest representatives of the second mortgage bondholders.[79]

The owner of the equity of redemption and the lessee in possession are necessary parties defendant.[80]

§ 403. Subsequent judgment creditors.—A mortgage or judgment prior in point of time is paramount to a subsequent judgment which is first enforced; and if it be enforced by a bill in equity to which the owner of the second judgment, or of the title acquired under it, is not made a party, such junior judgment creditor, or the purchaser under his execution, would have the right to redeem even after the statutory period of redemption had expired, because his rights would not be cut off by a foreclosure suit to which he was not made a party. This point is illustrated by one phase of the litigation in respect to the La Crosse and Milwaukee Railroad Company, afterwards the Milwaukee and Minnesota Company, and the Milwaukee and St. Paul Railway Company.[81] Without following in detail the complicated facts of the case, the legal point is made clear by the illustrations and reasoning of Mr. Justice Dyer: "Suppose a second mortgagee forecloses his mortgage and takes title under his foreclosure sale, but does not take possession. Suppose, then, a prior mortgagee forecloses his mortgage, does not make the second mortgagee a party, takes title under his foreclosure sale and gets possession, who has the paramount legal title? Clearly the prior mortgagee; but the second mortgagee's right of redemption is not cut off because he was not a party to the proceeding. Let us follow it further. Suppose the prior mortgagee forecloses his mortgage, does not make a second mortgagee a party, and gets title under a foreclosure sale. The second mortgagee is in possession, holding title under a foreclosure of his mortgage. The paramount title is again

[79] First Nat. Ins. Co. v. Salisbury, 130 Mass. 303.

[80] Beekman v. Hudson &c. R. Co. 35 Fed. 3; 36 Am. & Eng. R. Cas. 321; Jones Mortgages, §§ 1406–1413.

[81] Howard v. Milwaukee &c. R. Co. 7 Biss. (U. S.) 73, 80. And see Railroad Co. v. James, 6 Wall. (U. S.) 750; Bronson v. La Crosse &c. R. Co. 2 Wall. (U. S.) 283.

in the prior mortgagee, but he cannot have a writ of assistance or other process in his foreclosure proceeding against the second mortgagee to get possession of the premises, because that second mortgagee was not a party to his suit.[82] The equity of redemption of that mortgagee is not cut off, and if the prior mortgagee would get possession, in case the second mortgagee does not redeem, he must bring ejectment. I mention these only as illustrations of the general principle. Now a judgment creditor with a posterior lien issues execution, sells the property, and takes title. A prior judgment creditor prosecutes his bill in equity to enforce the lien of his judgment. The party in possession is sole defendant in the bill. A decree is rendered enforcing, not any lien created by the decree, but the lien of the judgment as of the date of the judgment, and a sale is ordered. The sale transpires, and then a contest arises upon the legal titles held respectively by the purchaser under the decree and the purchaser under the execution sale upon the subsequent judgment. I cannot come to any other conclusion than that the purchaser under the decree founded upon the first judgment in this state of the case takes the paramount legal title. True, the plaintiff was not a party to the bill filed upon the prior judgment, but the omission to make him a party did not give him superior legal rights. For rank of legal title we must look to the judgments from which the respective titles flow."

§ 404. **As a general rule it is neither necessary nor proper to make prior mortgagees parties** to a foreclosure suit,[83] unless a receiver is prayed for.[84] Of course, if the prior mortgagees assent to a sale of the entire property, and such a sale is desired, they must be made parties to the bill. It may sometimes be necessary or proper to make prior mortgagees parties in order to settle the amounts for which the mortgages are liens upon the property, as otherwise a purchaser at the foreclosure sale cannot know before bidding what the

[82] See, on this point, Terrell v. Allison, 21 Wall. (U. S.) 289; Hickey v. Stewart, 3 How. (U. S.) 750.

[83] Jones Mortgages, § 1439; Rose v. Page, 2 Sim. 471; Richards v. Cooper, 5 Beav. 304; Payne v. Hook, 7 Wall. (U. S.) 425, 432; Jerome v. McCarter, 94 U. S. 734, 736; Wabash &c. R. Co. v. Central Trust Co. 22 Fed. 138; Woodworth v. Blair, 112 U. S. 8; 5 Sup. Ct. 6.

[84] Miltenberger v. Logansport R. Co. 106 U. S. 286; 1 Sup. Ct. 140.

value of the property to be sold may be; and the complainants in the bill should put themselves in a position to inform purchasers what is the actual amount of prior incumbrances.[85] In the case of ordinary mortgages, it is seldom necessary to resort to any legal proceeding to determine the amount of the prior incumbrances; but with railroad mortgages this necessity more often arises, especially when there have been successive mortgages of portions of a road and afterwards of the entire road or of a consolidated road;[86] or when other complications have arisen to render the amounts for which the mortgages are valid liens uncertain.

A second mortgage, in so far as it touches property covered by the first mortgage, is of the equity of redemption only; in so far as it covers leased lines, it is of the leasehold interest only, without touching the rights of the lessors; and as to property of the mortgagor not covered by the first mortgage, it is independent of either. Therefore neither the first mortgagee nor the mortgagor, nor any lessor, is in strictness a necessary party to the foreclosure of the second mortgage, especially when all the property is in the hands of receivers in a suit of which the foreclosure is part.[87]

§ 404a. To make the prior mortgagee a party, unless there is a voluntary appearance, there must be a service of process upon him. A railroad mortgage is usually made to trustees, who represent the bondholders in all matters affecting their rights in court. But sometimes the bondholders are themselves the mortgagees, and in such case service of process must be made upon the individual bondholders in order to make them parties defendant. No general notice calling on them to present their claims will make them parties or bind them. If they are represented in the case by trustees, then a notice calling upon them to present their bonds before the master would be binding. But if they are in no way represented in the suit, their rights are not affected by any decree that may be rendered in the case.[88]

[85] Richards v. Chesapeake &c. R. Co. 1 Hughes (U. S.), 28, 35.

[86] Metropolitan Trust Co. v. Tonawanda &c. R. Co. 43 Hun (N. Y.), 521.

[87] Grand Trunk R. Co. v. Central Vermont R. Co. 88 Fed. 622.

[88] Young v. Montgomery &c. R. Co. 2 Woods (U. S.), 606, per Woods, J.

If a prior mortgagee is made a party to a foreclosure bill on the ground that a receiver is prayed for, and the order appointing a receiver is immediately served upon the prior mortgagee, he should protect his interests promptly, or he will be bound by the appointment, and by the subsequent authorized acts of the receiver.[89] After a receiver has been appointed in a suit to foreclose a second mortgage to which the first mortgagee has been made a party, a separate bill to foreclose the first mortgage cannot be brought, but a cross-bill can be brought for this purpose with the same force and effect as an independent suit.[90]

So long as a doubt exists as to the character and extent of a mortgage lien, a court of equity will not expose the property to sale under it, if the interest be capable of being reduced to a certainty.[91] In like manner, where the effort of the junior mortgagee is to obtain a sale of the entire property or estate, and not merely of the equity of redemption, there is reason for making the prior incumbrancers parties, for they have an immediate interest in the decree.[92]

A decree, declaring a mortgage to be a first lien upon the property and franchises of a railroad company, gives it no precedence over the prior lien of a party who had no notice of the proceedings, and was not a party nor privy to the decree.[93]

§ 405. When a foreclosure is sought subject to prior liens, the prior lien-holders are not prejudiced by the proceedings, and should not be made parties to them.[94] Senior mortgagees will not be made parties on their petition for the purpose of allowing them to contest a reorganization of the company, if it does not appear that the sufficiency of their security is thereby impaired. If their rights are in any way impaired, they should bring a separate action, either

[89] Miltenberger v. Logansport R. Co. 106 U. S. 286; 1 Sup. Ct. 140.

[90] Mercantile Trust Co. v. Atlantic &c. R. Co. 70 Fed. 518.

[91] Sutherland v. Lake Superior C. &c. Co. 1 Cent. L. J. 127; 9 N. Bank. 298; Jerome v. McCarter, 94 U. S. 734.

[92] Per Strong, J., in Jerome v. McCarter, 94 U. S. 734.

[93] Pittsburgh &c. R. Co. v. Marshall, 85 Pa. St. 187.

[94] McMurtry v. Montgomery Masonic Temple Co. 86 Ky. 206; 5 S. W. 570; McHenry's Petition, 9 Abb. N. C. (N. Y.) 256; Wabash &c. R. Co. v. Central Trust Co. 22 Fed. 138.

through their trustee, or, if he is hostile, then in their own names.[95] Neither will prior mortgagees be allowed to intervene for the purpose of petitioning to have the amount of their liens paid out of the proceeds of a foreclosure sale made subject to such liens.[96]

§ 406. In a suit to foreclose a mortgage, a prior mortgagee of a part of the property may be made a party, for if upon a sale under the first mortgage there should be a deficiency, it may become a question whether such deficiency is an indebtedness against the other property, subordinate to the mortgage thereon, or prior thereto, and this question should be determined, because the value of the other mortgage and of the property itself is affected.[97] But such prior mortgagee is entitled to have leave to institute separate foreclosure proceedings, and to have the property covered by his mortgage sold by itself, in the absence of any equitable reason estopping him from insisting on such right. He dealt with the mortgagor owning the particular piece of property upon the security of which he loaned his money; and it is his right to have that particular property sold by itself, and not have his property put up for sale with other property, so that he can protect his own interests, without being obliged to buy other property which he does not care for.[98]

§ 407. Priority of title may be tried in the foreclosure suit. It is competent in a foreclosure suit to make one a defendant who claims an equitable or legal title to the property superior to the title of the mortgagee, when the latter asserts that such title is not superior to his title under the mortgage, but is subordinate thereto. If it turns out that the title of the defendant is a prior legal or equitable title, a decree would not affect his rights, and the bill should be dismissed as to him. The question of priority of title can be tried in the foreclosure suit, if the bill contains proper averments

[95] McHenry's Petition, 9 Abb. N. C. (N. Y.) 256.

[96] Woodworth v. Blair, 112 U. S. 8; 5 Sup. Ct. 6.

The petition of a prior mortgagee to intervene in this way will be denied for the time being in case negotiations are pending for the sale of the entire property under a general mortgage. Central Trust Co. v. Wabash &c. R. Co. 25 Fed. 693.

[97] Olyphant v. St. Louis &c. Co. 23 Fed. 465.

[98] Olyphant v. St. Louis &c. Co. 23 Fed. 465.

that the defendant's title is subordinate to the title of the mortgagee.[99] Where prior mortgagees have been made parties to a foreclosure suit, the court may of its own motion order the bills to be dismissed as to such mortgagees, for they ought not to be put to the expense of making a defense.[100] But if a person claiming a prior lien is made a defendant, is served with process and appears but fails to answer, and a decree is entered declaring the mortgage for the enforcement of which the action is brought a first lien, and directing a sale which is duly made, the person claiming a prior lien, after waiting eleven years before doing anything, is estopped by the decree in the foreclosure suit.[102]

Upon the foreclosure of a mortgage upon a distinct portion of a railroad, the mortgagee of another distinct portion is not a necessary party. When the mortgagees of distinct divisions of the road both claim the same property, as, for instance, the machinery, rolling stock, franchises, and privileges of the entire road, the question what the mortgages cover is one which cannot be determined in a suit for foreclosure brought by one of the mortgagees.[103]

Where the property is sold before the rights of intervening parties are determined, and the court reserves power to hear such matters after the sale, the proper practice is for the purchaser, upon confirmation of the sale, to make himself a party to the foreclosure proceedings by filing a supplemental bill, and where the purchaser fails in such particular, the court should compel him to be made a party to the record.[104]

§ 408. Unsecured creditors of a corporation are not necessary or proper parties to an action to foreclose a mortgage upon its property and franchises, and they have no right to intervene therein. Any adjudication made against the mortgagor is binding upon them.[105]

[99] Harland v. Bankers' &c. Co. 33 Fed. 199; Lewis v. Smith, 9 N. Y. 502, 514, 515; 61 Am. Dec. 706n; Hollins v. Brierfield, &c. Co. 150 U. S. 371; 14 Sup. Ct. 127.

[100] Wabash &c. R. Co. v. Central Trust Co. 22 Fed. 138.

[102] Woods v. Pittsburgh &c. R. Co. 99 Pa. St. 101. See McKee v. Grand Rapids &c. R. Co. 41 Mich. 274; 1 N. W. 873; 50 N. W. 469.

[103] Bronson v. Railroad Co. 2 Black (U. S.), 524.

[104] Fitzgerald v. Evans, 49 Fed. 426.

[105] Bronson v. Railroad Co. 2 Black

§ 408a. **Lessees under a lease executed subsequent to a mortgage** are not necessary parties to a suit to foreclose the mortgages. The leases being subsequent and subject to the mortgage, the contract of leasing is wholly between the mortgagor and the lessee. The mortgagee has no privity with the lessee; not having assented to the lease, its rights are not affected thereby. Hence the tenants in possession are not necessary parties to the foreclosure suit, and the foreclosure sale operates to evict them by title paramount.[106]

§ 408b. **Under an ordinary mortgage of real estate, claims in antagonism to both mortgagor and mortgagee** may be considered outside the scope of the foreclosure and are properly relegated to independent suits. If the bondholder wishes to foreclose and exclude inferior lien-holders or general unsecured creditors he may do so, but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must generally secure and preserve the prior rights of general creditors. Hence a general creditor has the right to file an intervening petition charging an agreement between bondholders and stockholders to exclude from any interest in the property unsecured creditors, and should be made a party to the suit to enable him to protect his interests from the collusion and fraud of the mortgagor and mortgagee.[107]

§ 409. **A temporary receiver of a corporation, appointed in an action by the attorney general to dissolve it** on the ground of its insolvency, is not a necessary party to a suit subsequently brought to foreclose a mortgage made by the corporation; for such a temporary receiver in such action is not vested with the title to the property of the corporation. This remains in the corporation until a final judgment of dissolution is entered, when a final receiver or assignee is appointed to take it. The temporary receiver is not a trustee for creditors; he is a mere custodian and manager of the property under the direction of the court during the pendency of the action.[108]

(U. S.), 524; Stout v. Lye, 103 U. S. 66; Herring v. New York &c. R. Co. 105 N. Y. 340; 12 N. E. 763.

[106] Tyler v. Hamilton, 62 Fed. 187.

[107] Louisville Trust Co. v. Louisville &c. R. Co. 174 U. S. 674; 19 Sup. Ct. 827.

[108] Herring v. New York &c. R. Co. 105 N. Y. 340; 12 N. E. 763.

The court may, however, in its discretion, allow such temporary receiver to intervene in the foreclosure suit.[109]

409a. The right of minority stockholders of a corporation to intervene in a foreclosure suit when the corporation threatens, by collusion or otherwise, to neglect the proper defense of the suit, is established by a line of decisions,[110] but when they intervene they do so, not as individuals, but as stockholders, in the assertion of rights common to the stockholders, which the corporation itself has declined to protect.[111] Where the interveners seek no affirmative relief of their own, but ask only that foreclosure be denied on the ground that the mortgage, for different reasons, is invalid and void, they must stand upon the rights open to the corporation itself.[112]

The general rule of equity practice is that the chancellor has no power to make new parties defendant against the wishes of the complainant, but this rule does not apply to the intervening of a *cestui que trust* or a stockholder as such. The general rule applies only where those who seek to intervene make issues which would not be disposed of so as to become *res adjudicata,* provided the interveners were not made parties.[113]

The intervening stockholder must not be guilty of laches, and a delay of three years where the intervener had opportunity to investigate is such laches as bars the right to intervene and disturb settled titles.[114]

Counsel who appear for parties who intervene and unsuccessfully contest a foreclosure suit are not entitled to an allowance for compensation out of the fund realized by the foreclosure sale.[115]

§ 410. Individual stockholders are not generally allowed to be-

[109] Herring v. New York &c. R. Co. 105 N. Y. 340; 12 N. E. 763.

[110] Dodge v. Woolsey, 18 How. (U. S.) 331, 341; 15 L. Ed. 401; Davenport v. Dows, 18 Wall. (U. S.) 626; 21 L. Ed. 938; Guarantee Trust &c. Co. v. Duluth &c. R. Co. 70 Fed. 803.

[111] Dickerman v. Northern Trust Co. 176 U. S. 181, 188; 20 Sup. Ct. 311; 44 L. Ed. 423.

[112] Big Creek Gap &c. Co. v. American &c. Co. 127 Fed. 625.

[113] Central Trust Co. v. Washington County R. Co. 124 Fed. 813; Gregory v. Pike, 67 Fed. 837, 846; 15 C. C. A. 33.

[114] Central Trust Co. v. Peoria &c. R. Co. 104 Fed. 418.

[115] Phinizy v. Augusta &c. R. Co. 98 Fed. 776.

come parties to a foreclosure suit against a corporation.[116] In a special case, however, where there is an allegation that the directors fraudulently refused to attend to the interests of the corporation, a court of equity will, in its discretion, allow a stockholder to become a party defendant, for the purpose of protecting his own interests against unfounded or illegal claims against the company; and he will also be permitted to appear on behalf of other stockholders who may desire to join him in the defense.[117] "But this defense," says Mr. Justice Nelson, "is independent of the company and of its directors, and the stockholder becomes a real and substantial party to the extent of his own interests and of those who may join him, and against whom any proceeding, order, or decree of the court in the cause is binding, and may be enforced. It is true, the remedy is an extreme one, and should be permitted by the court with hesitation and caution; but it grows out of the necessity of the case and for the sake of justice, and may be the only remedy to prevent a flagrant wrong."

Generally, before individual stockholders will be allowed to set up in defense of a foreclosure the mismanagement of the affairs of the corporation in the interest of the holders of a majority in interest of the stock and bonds, they must show a demand upon, or refusal by, the directors or stockholders, to make this defense.[118]

The stockholders of a corporation need not be individually made parties to a suit by its creditors to obtain satisfaction out of surplus proceeds of a foreclosure sale, where the stockholders are repre-

[116] Des Moines Gas Co. v. West, 50 Iowa, 16; Alexander v. Searcy, 81 Ga. 536; 8 S. E. 630; 12 Am. St. 337; 36 Am. & Eng. R. Cas. 239; Foster v. Mansfield &c. R. Co. 36 Am. & Eng. R. Cas. 281; Central Trust Co. v. Marietta &c. Ry. Co. 48 Fed. 14.

[117] Bronson v. La Crosse &c. R. Co. 2 Wall. (U. S.) 283; Gunderson v. Illinois &c. Bank, 100 Ill. App. 461; Drake v. New York &c. Co. 36 App. Div. (N. Y.) 275; 25 N. Y. S. 225; Waymire v. San Francisco &c. R. Co. 112 Cal. 646; 40 Pac. 1086. See, also, Henry v. Travellers' Ins. Co. 16 Colo. 179; 26 Pac. 318.

[118] Alexander v. Searcy, 81 Ga. 536; 8 S. E. 630; 12 Am. St. 337; Hawes v. Oakland, 104 U. S. 450; Dimpfell v. Ohio &c. R. Co. 110 U. S. 209; 3 Sup. Ct. 573. For elaborate discussion and citation of authorities, see Farmers' &c. Co. v. New York &c. R. Co. 150 N. Y. 410; 44 N. E. 1043; 34 L. R. A. 76; 55 Am. St. 689.

sented both by the corporation and by a committee of their own.[119]

Where a void sale of corporate property has been made under a deed of trust, and the property has been delivered to the purchaser, the trustees and the purchaser are liable to the corporation for the proceeds; yet a decree against them will not be made in a proceeding by two stockholders holding small interests to which the corporation is not a party, though the suit be brought by these stockholders on behalf of themselves and all similarly situated who may come in to prosecute when after a long period no other shareholder comes forward to join in the suit.[120]

§ 411. Where a stockholder may intervene.—After a suit in equity has been properly instituted against a railroad company, its officers enjoined and a receiver appointed, a decree *pro confesso* entered, and an authentic report of the facts made to the court, which has thereupon ordered a sale of the property of the company, an individual stockholder cannot be permitted to intervene in the suit and file a cross-bill in the cause on a general charge of fraud and collusion on the part of the receiver, and an erroneous judgment on the part of the court in making the order. The receiver of the Memphis, El Paso and Pacific Railroad Company reported, among other things, that prior to the late civil war the company had surveyed a route from the eastern boundary of Texas to El Paso, and had graded about sixty-five miles of its road, but had not paid the contractor; that after the war, about twenty or twenty-five miles of road had been graded, about three miles of track had been laid down, and loose rails had been dropped along the line for a few miles further. "Ten locomotives, purchased in France, together with a lot of about one hundred and twenty tons of railroad iron, had been detained at New Orleans for non-payment of duties, which, in the case of the locomotives, exceeded their value. The other railroad iron had been sold or attached in New York for claims against the company. This, from the report of the receiver, seemed to have been the whole extent of the real operations of the company in the construction of its vast work across the whole northern portion of Texas, an extent of nearly a thousand miles; and in the accomplishment of this result, or at least so much of it as had been performed

[119] Railroad Co. v. Howard, 7 Wall. (U. S.) 392.

[120] Samuel v. Holladay, 1 Woolw. (Pa.) 400.

since the close of the war, there had been issued forty millions of stock and about thirteen millions of bonds and land certificates." Nothing else remained, as the result of this vast issue of securities, which the receiver could lay his hands on, except a few thousand shares of stock in two other railroads, and a residuum of less than three hundred thousand dollars of cash assets accruing from the sale of land-grant bonds in France to the amount of over $5,000,000, under a representation and pledge that the money should be devoted to the construction of the road, so as to secure the grant of lands which formed the basis of the mortgages and the only security for the payment of the bonds. "A more utterly fraudulent concern, a more empty bauble of speculation, is rarely to be met with in this highly speculating and fraudulent age," was the comment of the court upon this humiliating revelation of the facts of the case. And yet it appeared that the franchises and rights to grants of land belonging to the organization would be of much value in the hands of an honest and energetic organization; and the receiver reported an agreement which could be effected with a new company which would have the effect of securing the ultimate payment of the debts and obligations of record of the defendant company. This proposition, after being taken under consideration by the court and modified in some particulars, was approved, and the receiver was authorized to carry it into execution.

At this stage of the proceedings certain officers and stockholders of the company appeared and desired to be allowed to become parties to the suit, and to intervene for their respective interests. The order authorizing the receiver to effect the proposed sale was suspended until the interveners could formally present their case by petition or cross-bill and be heard. The complainants in the suit and the receiver thereupon applied for a rule to show cause why such order should not be vacated and set aside, and this was the question before the court in the present case. The petitioners objected to the proposed sale, and made general charges of fraud and collusion on the part of the receiver. But the court held that individual stockholders could not be allowed to intervene to set aside the proceedings, or to interpose obstacles to the progress of the suit.[121]

[121] Forbes v. Memphis &c. R. Co. 2 Woods (U. S.), 323, 331, 334. Mr. Justice Bradley said: "Rival creditors, by proceedings before a mas-

The admission of a stockholder to become a party defendant in

ter, may control the priority of their respective liens, and creditors or stockholders may contest the validity of claims of other creditors and stockholders, but all in subordination to the general object and purpose of the suit; to obtain administration of the company's assets and property. To be allowed to intervene as general defendants and contestants is another and different thing. This can be admitted only upon the ground before referred to, to wit: having an interest in the result as a stockholder or otherwise, and being able to show fraud and collusion between the plaintiffs in the suit and the officers of the company having charge of its interests. A suggestion, in the progress of the suit, that an officer of the court is disposed to act fraudulently, or that the court has made an injudicious or erroneous order, will not be a sufficient ground to allow such a party to intervene. Indeed, it is questionable whether, in any case where a suit is properly instituted against a corporation, a stockholder of that corporation can, even on a suggestion of fraud on the part of its officers, come in by way of intervention as party to that suit, and seek to defend or control the proceedings. An original bill would rather seem to be the proper mode of proceeding. . . . A stockholder, in his character of stockholder, cannot sue, nor, unless specially made liable by the charter, can he be sued for any of the company's transactions. There is one case, and one only, in which he can interpose, and that is where the officers and managers of the company, by fraud and collusion with third persons, are sacrificing, or are about to sacrifice and betray, the interests of the corporation. For such breach of trust, and conspiracy he can call the guilty parties to an account in a court of equity. In the case before the court, the complainants might possibly have held the officers and agents of the company personally liable for the frauds and misrepresentations charged against them. But the said officers and agents were clothed with all of the authority and power of the corporation, and negotiated and operated in its name, and issued its obligations upon its corporate credit, and in every official way involved and pledged its corporate liability, and being the legal representatives of the corporation, placed before the world as such by the corporation, the parties injured had a perfect right to proceed against the corporation for redress. It cannot be, and is not seriously pretended, that the principal complainants in the case, the trustees of the land grant mortgages and bondholders, are acting in collusion with the officers of the company, or that they have any other object in view than the protection and security of the bondholders, who, it is admitted, have been most outrageously defrauded out of their money."

See Land Title &c. Co. v. Asphalt Co. 127 Fed. 1, where the charge of fraud was not substantiated. See, also, Dickerman v. Northern Trust Co. 176 U. S. 181; 20 Sup. Ct. 311.

any case where he is not made so by the bill, being a matter of discretion with the court, to be exercised with caution, and only as an extreme remedy, the court did not deem it necessary to depart from the general rule in this case, where the interests of all parties, and especially of the *bona fide* creditors of the corporation, were obviously coincident with the objects of the suit, and the order of sale which had already been made.[122]

In considering the question of laches by a stockholder in applying for relief, it is decisive against him that he will not receive some benefit from the relief asked for.[123]

After stockholders have been made parties to the foreclosure suit, they may litigate in the same suit the validity of a judgment against the corporation.[124]

§ 411a. **A state is not exempt** from the rule that to authorize intervention in a foreclosure suit there must be such an interest in the subject-matter of the litigation as would justify an independent action. Consequently it has been held that a state cannot intervene without showing a public interest to be involved.[125] Still it has been held that, where a state has brought *quo warranto* proceedings against a corporation, the court may, in adjudging the forfeiture, appoint a receiver or make any other order, although the state is not a creditor of the corporation.[126]

§ 412. **Adverse interests as between co-defendants may be passed upon and decided;** and parties are often made defendants because they will not join as plaintiffs, and are yet necessary parties to the suit, in order that they may be bound by the decree. Having in this way an opportunity of asserting their rights, they are concluded by the decree so far as it affects rights passed upon by the court.[127]

[122] Denying the stockholders' petition was not a breach of discretion in Stradley v. Pailthorp, 96 Mich. 287; 55 N. W. 807.

[123] Foster v. Mansfield &c. R. Co. 146 U. S. 88; 13 Sup. Ct. 28.

[124] Nelson v. Blaisdell, 23 Oreg. 507; 32 Pac. 391.

[125] State v. Loan & Trust Co. 81 Tex. 530; 17 S. W. 60.

[126] Texas &c. R. Co. v. State, 83 Tex. 1; 18 S. W. 199.

[127] Corcoran v. Chesapeake &c. Co. 94 U. S. 741.

When a right of priority is in dispute it ought to be settled before a sale, so that the party holding the first incumbrance can bid upon the property up to the amount of his claim.[128]

§ 413. **It is a general rule that strangers to a cause cannot be heard** in it either by petition or motion. Their remedy is by original bill. But there is an exception to the rule as regards creditors who are allowed to prove debts, and persons belonging to a class on whose behalf a suit is brought, as, for instance, bondholders for whom mortgage trustees have brought an action for foreclosure. Such persons are regarded as *quasi* parties, and of course have a standing in court.[129]

A security may be enforced upon a cross-bill filed by a defendant;[130] and where bondholders or mortgagees claim and assert antagonistic interests under a mortgage, a cross-bill is proper and necessary to adjust and settle these conflicting liens and priorities.[131]

IV. *Defenses.*

§ 414. **In general.**—In a bill to foreclose a mortgage given to secure negotiable railroad bonds, as against *bona fide* purchasers of the bonds for value, no other or further defenses to the mortgage are allowed than would be allowed were the action brought in a court of law upon the bonds. Such bondholders, in this respect, stand in the same position as *bona fide* assignees for value and before maturity of negotiable promissory notes.[132]

The general rule is that the burden of proof is on the defendant to show that a person holding negotiable securities purchased in the

[128] Campbell v. Texas &c. R. Co. 2 Woods (U. S.), 263

[129] Anderson v. Jacksonville &c. R. Co. 2 Woods (U. S.), 628; Chickering, In re, 56 Vt. 82; Coe v. New Jersey &c. R. Co. 31 N. J. Eq. 105.

[130] Railroad Co.'s v. Chamberlain, 6 Wall. (U. S.) 748.

[131] Morton v. New Orleans &c. R. Co. 79 Ala. 590; Gilman v. New Orleans &c. R. Co. 72 Ala. 566; American Loan &c. Co. v. East &c. R. Co. 37 Fed. 242.

[132] Kenicott v. Supervisors, 16 Wall. (U. S.) 452; following Carpenter v. Longan 16 Wall. (U. S.) 271; Atlantic Trust Co. v. Crystal Water Co. 72 App. Div. (N. Y.) 539; 76 N. Y. S. 647, citing text.

open market is not a *bona fide* holder; but in cases where there is clear proof of fraud or illegality shown in the issue of such securities the burden of proof shifts, and the holder is then required to show that he is an innocent purchaser.[133]

After a long delay, neither the defendant company nor a bondholder will be allowed to file an answer, after having consented to the proceedings, without producing affidavits excusing the delay or explaining the company's consent, and without offering to provide for the interest due and the expenses incurred and to be incurred by the receiver in possession.[134]

A sale in foreclosure proceedings will not be postponed merely because a railroad is more prosperous, when it would take nearly ten years of such prosperity to pay overdue interest. It is too late, two days before a sale, to ask for postponement, without a tender of the debt.[135]

§ 415. A junior mortgagee cannot deny the validity of a prior mortgage which he has assumed. Where a mortgage of a railroad is made in express terms subject to a prior mortgage of the same property, securing bonds negotiable in form, and which have in fact passed into circulation before the making of the junior mortgage, the junior mortgagees, and all parties claiming under them, are estopped from denying the amount or the validity of such bonds.[136]

By an application of the same principles, a railway company in possession of a branch line under an operating contract, wherein it assumes a mortgage on such line, cannot acquire an equitable lien, prior to the mortgage, on any of the mortgaged property.[137]

A purchaser from a company which has mortgaged its property and franchises cannot, on a bill to foreclose the mortgage, question

[133] M'Vicar Realty Trust Co. v. Union R. &c. Co. 136 Fed. 678.

[134] Central Trust Co. v. Texas &c. R. Co. 24 Fed. 151, 153.

[135] Duncan v. Atlantic &c. R. Co. 88 Fed. 840.

[136] Bronson v. La Crosse &c. R. Co. 2 Wall. (U. S.) 283; and see Minnesota Co. v. St. Paul Co. 6 Wall. (U. S.) 742; Jerome v. McCarter 94 U. S. 734; Central Trust Co. v. Columbus &c. R. Co. 87 Fed. 815.

[137] Terre Haute &c. R. Co. v. Harrison, 88 Fed. 913.

the incorporation of the mortgagor company, whose acts constitute the only source of the purchaser's title.[138]

§ 416. **Subsequent contracts of the company.**—Until a mortgagee takes possession under his mortgage, or files a bill to foreclose it, and obtains the appointment of a receiver, he is in no way responsible for the dealings of the mortgagor with third persons, such, for instance, as the leasing of a railroad which is the subject of the mortgage, although the lease be fraudulent against the company. Such dealings, after the execution of the mortgage, cannot affect the rights of the mortgagee, and he has no control over them.[139] He has no interest in the earnings of the road, or concern in the appropriation of them, until he takes possession or obtains the appointment of a receiver. Therefore the stockholders of a railway company cannot set up such matters in defense to a foreclosure suit.[140]

§ 416a. **Whether complainants are conducting a foreclosure suit from good or bad motives,** for their own benefit or for the benefit of another, is immaterial. It is no defense to a legal demand instituted in the mode and according to the practice of a court that the complainant is actuated by personal or improper motives. The motives of a suitor cannot be inquired into; were it otherwise, nearly every suit would degenerate into a wrangle over motives and feelings.[141] Consequently an allegation that a mortgage is being foreclosed to close out the minority stockholders and get rid of certain interests is no defense.[142]

§ 416b. **A tender of money due on a bond,** to defeat a pending foreclosure suit, must be offered in payment of the bond. To make an effectual tender, it must appear that at the time when it was made the party making it had the right to tender payment of the

[138] Beekman v. Hudson Riv. R. Co. 35 Fed. 3.

[139] Hale v. Nashua &c. R. Co. 60 N. H. 333.

[140] Bronson v. La Crosse &c. R. Co. 2 Wall. (U. S.) 283.

[141] McMullen v. Ritchie, 64 Fed. 253; State v. Ross, 12 Mo. 435; 25 S. W. 947; Toler v. East Tenn. &c. R. Co. 67 Fed. 168.

[142] Guardian Trust Co. v. White Cliffs &c. Co. 109 Fed. 523.

debt. The demand should clearly disclose the right of the party making the offer. Hence the person making a tender has no right to demand an assignment of the bond, and such a demand on an attorney conducting the foreclosure suit would also be bad, because the attorney would not be authorized to assign the security, though, if it is in his hands for collection, he would be justified in accepting payment.[143]

V. *Decrees.*

§ 417. Decree of sale of railroad situate in two states.—The fact that a railroad company, whose road runs through two states, is incorporated in both, does not prevent a court sitting in one of these states from ordering a sale of the entire property situated in both states, under a mortgage of the entire line of road executed by one corporate body. The execution of the mortgage in this way would estop the corporation from setting up a separate existence in the two states. Moreover, there is no reason why a corporation chartered by two states may not constitute one and the same corporate body.[144]

[143] Whittaker v. Belvidere &c. Co. 55 N. J. Eq. 674; 38 Atl. 289.

[144] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 447, 454; McElrath v. Pittsburgh &c. R. Co. 55 Pa. St. 189; Muller v. Dows, 94 U. S. 444, 449. Mr. Justice Strong, delivering the judgment of the Supreme Court of the United States in favor of the validity of such a decree, said: "If such a foreclosure and sale cannot be made of a railroad which crosses a state line and is within two states, when the entire line is subject to one mortgage, it is certainly to be regretted; and to hold that it cannot be, would be disastrous, not only to the companies that own the road, but to the holders of bonds secured by the mortgage. Multitudes of bridges span navigable streams in the United States,—streams that are boundaries of two states. These bridges are often mortgaged. Can it be that they cannot be sold as entireties by the decree of a court which has jurisdiction of the mortgagors? A vast number of railroads partly in one state and partly in an adjoining state, forming continuous lines, have been constructed by consolidated companies, and mortgaged as entireties. It would be safe to say that more than one hundred millions of dollars have been invested on the faith of such mortgages. In many cases these investments are sufficiently insecure at the best. But if the railroad, under legal process, can be sold only in fragments; if, as in this case, where the mortgage is upon the whole line, and includes

In New Jersey[145] it is provided by statute that railroad corporations existing by or under the laws of another state, any part of whose routes, whether acquired by lease or otherwise, lie within this state, or which are authorized to exercise any franchise within this state, shall be deemed corporations of this state, for the purpose of being sued, or proceeded against if insolvent, in the same manner and to the same extent as if organized originally therein, and no suit of foreign attachment shall be brought against any such corporation. In case suit shall be brought for the foreclosure of any mortgage of the franchises and railroads of any such corporation in the state of its original creation and domicile and also of the same mortgage in the Court of Chancery of this state, the suit in the Court of Chancery shall, so far as consistent with the protection of parties having acquired liens in this state, be regarded and conducted as auxiliary to the said suit brought in said state where such corporation was originally created and domiciled: and upon decree obtained in the last mentioned suit for the foreclosure of such mortgage, and for the sale of the property and franchises thereby conveyed, including such property and franchises in New Jersey, to pay and satisfy the mortgage and other liens which may be established by such de-

the franchises of the corporation which made the mortgage, the decree of foreclosure and sale can reach only that part of the road which is within the state,—it is plain that the property must be comparatively worthless at the sale. A part of a railroad may be of little value when its ownership is severed from the ownership of another part. And the franchise of the company is not capable of division. In view of this, before we can set aside the decree which was made, it ought to be made clearly to appear beyond the power of the court. Without reference to the English chancery decisions, where this objection to the decree would be quite untenable, we think the power of courts of chancery in this country is sufficient to authorize such a decree as was here made. It is here undoubtedly a recognized doctrine that a court of equity, sitting in a state and having jurisdiction of the person, may decree a conveyance by him of land in another state, and may enforce the decree by process against the defendant. True, it cannot send its process into that other state, nor can it deliver possession of land in another jurisdiction, but it can command and enforce a transfer of the title. And there seems to be no reason why it cannot, in a proper case, effect the transfer by the agency of the trustees when they are complainants." See §§ 358–360.

[145] Laws 1876, ch. 78, §§ 1, 2; 2 R. S. 1877, p. 921, §§ 71–81.

cree by such officers as shall be designated therefor, the Court of Chancery in this state shall be empowered so to frame its decree for foreclosure and sale under said mortgage, to satisfy the same and such other liens which by its said decree it shall establish, as that sale may be made thereunder, out of this state, and at the same time and place of the sale under the judgment or decree obtained in said other state, and under such regulations as to advertisement thereof as to the chancellor shall seem fit.

§ 418. **Decrees entered by consent,** in like manner as decrees in *ex parte* cases, so long as they remain unexecuted, are subject to the control of the court. Such decrees have legal effect so long as they stand unreversed; but in fact they are the agreements of the parties, which the court merely assents and gives effect to, and are not judicial determinations.[146] So long as such decrees have not been acted upon, the court is at liberty to correct them according as the court may afterwards judicially ascertain the facts and the law. But this power does not exist after such decrees have been carried into effect. They are then regarded as final and estop the parties and their privies from calling them in question.[147] A consent decree entered upon the basis of an agreement between the parties, by which the execution of a decree against a railroad company was suspended upon certain terms, must be executed by the company when the other party has complied with the agreement on his part. Where, by such a decree, the railroad company was to pay certain instalments of a debt at certain dates until the whole was paid, and if default was made the complainants were to wait ninety days before making a seizure and sale of the property, proceedings for sale after the ninety days' indulgence will not be stayed, except upon some ground founded upon the agreement; the company must show a desire or willingness to

[146] Vermont &c. R. Co. v. Vermont &c. R. Co. 50 Vt. 500; 14 Am. Railw. R. 497, 531, per Barrett, J.

[147] Wadhams v. Gay, 73 Ill. 415; Edgerton v. Muse, 2 Hill (S. C.), Ch. 51; Farmers' &c. Co. v. Central R. Co. of Iowa, 4 Dill. (U. S.) 533. And see, further, Union Bank v. Marin, 3 La. Ann. 34, 35. "Consent decrees decide nothing. They merely authenticate private agreements, and render them executory between the parties." Per Rost, J.

comply with the substance of the agreement. The equities of third parties are no ground on which to base such a petition.[148]

An appeal will not be dismissed upon the ground that the decree from which it was taken was rendered by consent; but no errors will be considered upon the appeal which were in law waived by such consent.[149]

§ 419. **When a decree made by consent is beyond the scope of the original bill,** and not in accordance with settled principles of law, although the parties are bound by it after it has been acted upon by either of them, yet the court, not having made the decree in the exercise of a judicial judgment or deliberation, will not be bound to regard it beyond the specific matter which is the subject of the decree. The court is free to adopt a different policy at a subsequent stage of the case. Thus, in the case of the Vermont Central Railroad Company,[150] after a receiver had been regularly appointed by the court, and had been in possession of the road for some years, the parties made a compromise which in fact discharged the debt for the liquidation of which the receivership was created, so that the occasion for the receivership no longer existed. This compromise "was devised and put in form as the outcome of the mind and will of the parties, as the mode of consummating into validity a mutual arrangement by the parties as to their respective rights and interests, and as to the mode and means by which the property was to be held and used in serving and satisfying those rights and interests. That decree adopted what had been created by the court as a receivership, as known and warranted by the law; but the administration of

[148] Anderson v. Jacksonville &c. R. Co. 2 Woods (U. S.), 628.

[149] Pacific R. v. Ketchum, 101 U. S. 289.

[150] Vermont &c. R. Co. v. Vermont &c. R. Co. 50 Vt. 500, 550, 564, 582; 14 Am. Railw. R. 497, 538, 550. "The court could not, in the first instance, bind by judgment, decree, and order, beyond the scope of the original bill, except by consent, and by acquiescence in the execution thereof, and it would be without warrant for the court to supervene upon what has come to pass in virtue of agreement, consent, and acquiescence, and deal with the subject and the parties the same as if all had been done within the scope of the original bill and under the original decree, in the legitimate exercise of judicial prerogative, in the discharge of judicial duty, and as the result of independent judicial judgment."

it was not left to the judicial judgment and direction of the court under the law authorizing and governing a receivership, known to the law as such. Instead thereof the parties enacted a code *ex contractu* for the administration of the property, and provided *ex contractu* that there should be the formality as of a decree supervening thereupon." The administration proceeded for ten years or more before there was any adverse litigation between the parties, during which time there were many ancillary decrees and orders mainly agreed upon by the parties. Such administration, although called a receivership in the proceedings, and having the form of one, was practically one by agreement of the parties. The court did not exercise its own prerogative and control except in subordination to the agreement of the parties. Its function was virtually the giving of formal assent to what had been devised and agreed upon by the parties. The court, therefore, upon the occurrence of adverse litigation at a later stage of the cause, did not hesitate to declare that this receivership was not a receivership in law.

§ 420. **Final decree.**—A decree in a foreclosure suit fixing the amount of interest due on a mortgage, and providing for a sale unless payment be made within a year, is a final decree from which an appeal may be taken.[151] Such decree is not, however, appealable as a final order, where it also contains a reference to a master to report the amount of all prior liens, a detailed statement of the properties to be sold, the form of the order of sale, and the form of the advertisement of sale.[152] A decree which does not fix the amount due upon the mortgage, nor ascertain and define the property to be sold under the decree, is not final in the sense which allows an appeal from it.[153]

[151] Milwaukee &c. R. Co. v. Soutter, 2 Wall. (U. S.) 440; Blossom v. Milwaukee &c. R. Co. 1 Wall. (U. S.) 655; Hinckley v. Gilman &c. R. Co. 94 U. S. 467; Ray v. Law, 3 Cranch (U. S.), 179; Forgay v. Conrad, 6 How. (U. S.) 201; Bronson v. La Crosse &c. R. Co. 2 Black (U. S.) 524; Grant v. Phoenix Ins. Co. 106 U. S. 429; 1 Sup. Ct. 414; Chicago &c. R. Co. v. Fosdick, 106 U. S. 47; 1 Sup. Ct. 10; First Nat. Bank v. Shedd, 121 U. S. 74; 7 Sup. Ct. 807.

[152] Parsons v. Robinson, 122 U. S. 112; 7 Sup. Ct. 1153.

[153] Railroad Co. v. Swasey, 23 Wall. (U. S.) 405; Bostwick v. Brinkerhoff, 106 U. S. 3; 1 Sup. Ct. 15.

After an injunction restraining a sale under a deed of trust, a decree dissolving the injunction, and directing a sale according to the deed of trust, and the bringing of the proceeds into court, is a final decree from which an appeal may be taken.[154]

An order appointing a receiver is a final order from which there may be an appeal.[155]

A final decree may be modified or set aside,—1. By appeal within the time allowed; 2. By bill of review filed within the time allowed for an appeal, charging error apparent upon the record; and 3. By original bill charging fraud or newly discovered evidence.[156]

A decree of foreclosure takes effect from its date, and an appeal must be taken within the time allowed by rule, although the commissioner to execute the sale is not appointed until some time afterwards.[157]

§ 421. There may also be a final decree in a matter distinct from the general subject of litigation, which affects only the parties to the particular controversy, or parties in interest in that matter who may intervene and appeal. Thus there may be an appeal from an order for allowance of costs and expenses to a complainant suing on behalf of a trust fund.[158] Thus, also, a decree in a foreclosure suit fixing the compensation to be paid to the trustees under the mortgage is a final decree as to that matter, from which an appeal may be taken; and a bondholder is entitled to intervene to contest the matter and to appeal from an adverse decision.[159] The purchasing committee at a sale acting in behalf of the bondholders have a like interest, and may appeal from an adverse decision in respect to the trustees' compensation.[160]

The decision of a circuit court, on a petition of intervention in a foreclosure suit, sustaining the intervener's claim, is a "final de-

[154] Railroad Co. v. Bradleys, 7 Wall. (U. S.) 575.

[155] Cincinnati &c. R. Co. v. Sloan, 31 Ohio St. 1.

[156] Huntington v. Little Rock &c. R. Co. 16 Fed. 906.

[157] Duncan v. Atlantic &c. R. Co. 4 Hughes (U. S.), 125.

[158] Trustees v. Greenough, 105 U. S. 527.

[159] Williams v. Morgan, 111 U. S. 684; 4 Sup. Ct. 638. See this case for citations of other instances of such appeals.

[160] Williams v. Morgan, 111 U. S. 684; 4 Sup. Ct. 638.

cision" within the Act of Congress giving the Circuit Courts of Appeals jurisdiction to review final decisions of the circuit courts.[161]

If the decree of sale in a suit for foreclosure provides that the purchaser shall pay down a certain sum in cash when the sale is made, and do certain other acts prescribed, the purchaser is bound by the decision of the court as to such other claims, and has no appealable interest therein.[162]

§ 421a. **A court of equity has the power so to mould its decree as to order a sale** of mortgaged premises to satisfy that part of the mortgage debt which is due, and preserve the lien upon the mortgaged premises in the hands of the purchaser as to the unmatured part of the debt.[163]

A decree allowing only ten days in which to pay the amount found due and thus prevent a sale on foreclosure is not objectionable when the sale is advertised for sixty days and a further time of ninety days given before confirmation, during which time the right of redemption continued. This constituted a substantial compliance with the requirement for six months as a reasonable period within which to redeem.[164]

§ 422. **A decree for the sale of a railroad under foreclosure proceedings should name an upset price,** sufficient to cover all costs, allowances made by the court, receiver's certificates and interest, liens prior to the mortgage bonds, amounts divested from the earnings, and all undetermined claims, which will be settled before the confirmation and sale.[165]

The decree may provide that the sale shall be made subject to contingent claims, or subject to such claims as shall be finally adjudicated, where the amount of such claims depends upon a long course of litigation.[166]

[161] Central Trust Co. v. Marietta &c. R. Co. 48 Fed. 850.

[162] Central Trust Co. v. Grant Locomotive Works, 135 U. S. 207; 10 Sup. Ct. 736. See, also, Compton v. Jesup, 167 U. S. 1; 17 Sup. Ct. 795.

[163] Pennsylvania R. Co. v. Allegheny Val. R. Co. 48 Fed. 139.

[164] Wells v. Northern Trust Co. 195 Ill. 288; 63 N. E. 136.

[165] Blair v. St. Louis &c. R. Co. 25 Fed. 232; Central Trust Co. v. Washington County R. Co. 124 Fed. 813.

[166] Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 380.

§ 423. The court which has entered a decree of sale of a railroad may, in its discretion, delay the sale, to await a better condition of the finances and business of the country, and thus secure a better price for the property. But the mere fact that a railroad company has begun, after a period of financial adversity, to show an improvement in its earnings, indicating that in after years it will be able to pay off an accumulation of overdue interest, does not furnish ground for a postponement of a foreclosure sale, especially if the company offers no guaranty that it will redeem the mortgage within a reasonable time.[167]

A court of equity, pending an appeal without supersedeas, from a final decree in a foreclosure suit, settling the priority of liens and fixing a day for sale, has power to postpone the sale, if a sale on the day fixed would be oppressive or unjust.[168]

§ 424. Liability on supersedeas bond.—When a defendant appeals from a decree of foreclosure and gives a bond for a *supersedeas,* and the decree is affirmed, the liability upon the bond is limited to such damages as resulted from a delay in the sale of the lands, and does not include the balance remaining unpaid of the decree after applying thereto the proceeds of the sale, nor does it include the interest thereon which accrued pending the appeal. The bond is only to indemnify the plaintiff against loss by reason of the delay, and the amount of this depends in each case upon its own facts.[169]

[167] Duncan v. Atlantic &c. R. Co. 4 Hughes (U. S.), 125.

[168] Bound v. South Carolina R. Co. 55 Fed. 186.

[169] Supervisors v. Kennicott, 103 U. S. 554, 558. "The agreed case shows that there was an accumulation of interest on the debt during the appeal largely exceeding the penalty of the bond, and that a balance of the mortgage debt, also much more than the penalty of the bond, was left unpaid when the proceeds of the sale had all been applied in accordance with the terms of the decree. This is the extent of what was agreed on. There is no statement that the lands had depreciated in value, or that taxes had accumulated. Neither is it stated that any loss had actually accrued to the appellees by reason of the stay of sale. So far as appears, the lands may have increased in value to an amount larger than the accumulation of interest, and the taxes may have been paid." Also see Jerome v. McCarter, 21 Wall. (U. S.) 17.

§ 424a. **Bonds need not be put in evidence prior to a decree of foreclosure and sale,** the testimony of both parties showing the entire number were certified and issued by the company. It is sufficient to prove that the bonds are valid and are outstanding obligations, and it is not necessary to show in whose hands they are, or to require their production. Months and even years might be required to produce them all. The practice is to order a decree of foreclosure and sale without their production.[170] Issues concerning the ownership of the bonds are ones which in the orderly progress of the cause necessarily have to be tried as between rival claimants, when the trustee is called upon to distribute the proceeds of the foreclosure sale. It is wholly unnecessary to consider them before that time.[171]

424b. On a sale under decree of foreclosure of the property and franchises of a railway company, mortgaged by permission, a conveyance of such property and franchises, as directed by the court, divests the company of all right, title, and interest. The company has only remaining its franchise to exist as a corporation, and it cannot, by any act or negligence, thereafter subject the property so sold, or the franchise of the corporation to exercise the rights of a railway company, to liability.[172]

Where a decree for sale expressly provides that creditors claiming to have prior rights to the property may present their claims to the court for adjudication before distribution of the proceeds of the sale, such creditors have no right to complain of the decree.[173]

§ 424c. **A covenant that trustees should be allowed all necessary expenses for attorney and counsel fees** is one of the usual covenants and agreements in a mortgage deed of trust, and such a provision justifies a court in allowing counsel fees in a suit for foreclosure of the mortgage.[174] But a covenant to pay the trustee's ex-

[170] Dickerman v. Northern Trust Co. 176 U. S. 181; 21 Sup. Ct. 311; Weed v. Gainesville R. Co. 119 Ga. 576, 591; 46 S. E. 885; Toler v. East Tennessee &c. R. Co. 67 Fed. 168.

[171] Sioux City &c. R. Co. v. Manhattan Trust Co. 92 Fed. 428.

[172] Central Trust Co. v. Western &c. R. Co. 112 Fed. 471.

[173] Central Trust Co. v. United States &c. Co. 56 Fed. 5.

[174] Southern Cal. &c. Co. v. Union &c. Co. 64 Fed. 450.

penses on a sale does not entitle him, as a matter of right, to have attorney's fees taxed in a suit to foreclose, although it became necessary to foreclose by action.[175]

[175] **Robinson v. Alabama &c. Mfg. Co. 51 Fed. 268.**

CHAPTER XIV.

THE APPOINTMENT AND JURISDICTION OF RECEIVERS.[1]

I. Grounds for the appointment of receivers, §§ 425–457.
II. Selection of receivers, §§ 458–460.
III. Jurisdiction of receivers, §§ 461–473.

I. *Grounds for the Appointment of Receivers.*

§ 425. **The English rule in regard to the appointment of receivers at the suit of a mortgagee** formerly was[2] that a senior mortgagee could not generally obtain such appointment, because, having the legal title, he had full remedy at law for the recovery of possession by ejectment. When, however, his interest was such that he could not maintain ejectment, as, for instance, when that interest was the "undertaking" of a railway or canal company, or the rates,

[1] Without dealing much with elementary matters, the present chapter will present so much of the subject as relates to the appointment of receivers, and their jurisdiction over the property, and the succeeding chapter will relate to to their duties and liabilities. It is neither practicable nor desirable to embrace in this treatise the whole subject of the Law of Receivers. For the general law of this subject, reference may be had to the excellent work of Mr. High. The subject is developed here only so far as it relates directly to the enforcement of corporate securities.

[2] Myatt v. St. Helen's &c. R. Co. 2 Q. B. 364; Potts v. Warwick &c. Canal Co. Kay, 142, 146; Bowen v. Brecon R. Co. L. R. 3 Eq. 541; Fripp v. Chard R. Co. 11 Hare, 241; Hopkins v. Worcester & B. Canal, L. R. 6 Eq. 437; Ames v. Birkenhead Docks, 20 Beav. 332, 342.

tolls, and dues arising therefrom, he might come into court for a receiver.[3] But, prior to a recent statute upon this subject, it was held that the remedy of a mortgagee of a railway company for the enforcement of the debt did not extend to the obtaining of a receiver to manage and operate the road.[4] The Court of Chancery will, however, appoint a receiver of tolls or earnings of the company when these are liable to the payment of the debt. This is a remedy essentially different from the appointment of a manager of the undertaking.[5] The appointment of a receiver, at the suit of a mortgagee

[3] Myatt v. St. Helen's &c. R. Co. 2 Q. B. 364.

[4] In consequence of the refusal of the Court of Chancery to give this remedy, a statute was enacted, in 1867, for the appointment of a manager of a railway company, at the suit of a judgment creditor. See 30 & 31 Vict. ch. 127; 38 & 39 Vict. ch. 31; Manchester &c. R. Co. In re, L. R. 14 Ch. D. 645; Birmingham &c. R. Co. In re, L. R. 18 Ch. D. 155.

[5] De Winton v. Brecon, 26 Beav. 533, 542.

Upon an application to the Rolls Court for a receiver, Sir John Romilly, Master of the Rolls, appointed a receiver of the tolls and rents, but said: "I do not think I can give to the receiver such power of management of the affairs of the corporation as would make him liable to proceedings by the attorney general by mandamus, or the like. I am not aware whether the letting by the receiver, instead of the corporation, would have that effect; but, if it would, then the letting should be by the corporation, but the rents should be secured by the receiver."

In a case before the English Court of Appeal in Chancery (Gardner v. London &c. R. Co. L. R. 2 Ch. 201, 212), upon the question of appointing a receiver of a railway company in behalf of mortgages, Lord Cairns said: "In addition to the general principle that the Court of Chancery will not in any case assume the permanent management of a business or undertaking, there is that peculiarity in the undertaking of a railway which would, in my opinion, make it improper for the Court of Chancery to assume the management of it at all. When parliament, acting for the public interest, authorizes the construction and maintenance of a railway, both as a highway for the public, and as a road on which the company may themselves become carriers of passengers and goods, it confers powers and imposes duties and responsibilities of the largest and most important kind, and it confers and imposes them upon the company which parliament has before it, and upon no other body of persons. These powers must be executed and these duties discharged by the company. They cannot be delegated or transferred. The company will, of course, act by its servants, for a corporation cannot act otherwise, but the re-

of tolls, is one of the oldest remedies of the court, and not dependent upon any statute.[6]

§ 426. **In the United States, courts of equity have exercised their powers with much more freedom** in the appointment of receivers of railways. Generally, however, the doctrine is fully recognized that courts assume the management of railroads only with a view to the winding up of insolvent companies, or to the sale of their property for the benefit of the mortgage creditors; that, in the larger class of cases, justification of the appointment of a receiver springs out of the jurisdiction of courts thus to liquidate and sell; and that, in these cases, roads are managed and their business continued, through the intervention of receivers, in order that the roads may be sold without loss of business and depreciation of the property,[7] and as well to preserve the rights of the public in having the railroad in operation as a highway for public transportation. In this way the property is preserved pending the litigation, and used for the benefit of all concerned, with the ultimate purpose of disposing of the property itself, and obtaining assets with which to pay off the mortgage upon foreclosure of it. There are other circumstances which will justify the interference of a court of equity by the appointment of

sponsibility will be that of the company. The company could not, by agreement, hand over the management of the railway to the debenture holders. It is impossible to suppose that the Court of Chancery can make itself or its officer, without any parliamentary authority, the hand to execute these powers, and all the more impossible when it is obvious that there can be no real and correlative responsibility for the consequences of any imperfect management. It is said that the railway company did not object to the order for a manager. This may well be so. But, in the view I take of the case, the order would be improper even if made on the express agreement and request of the company."

[6] Hopkins v. Worcester &c. Co. L. R. 6 Eq. 437.

[7] Milwaukee &c. R. Co. v. Soutter, 2 Wall. (U. S.) 510; Souter v. La Crosse &c. R. Co. Wool. (U. S.) 49; Florida v. Jacksonville &c. R. Co. 15 Fla. 201, 286; Heinsheimer v. Dayton &c. R. Co. 3 Railw. & Corp. L. J. 268; Beverley v. Brooke, 4 Gratt (Va.) 187; Allen v. Dallas &c. R. Co. 3 Woods (U. S.), 316; Wallace v. Loomis, 97 U. S. 146, 162; Mercantile Trust Co. v. Missouri &c. R. Co. 36 Fed. 221; 4 Railw. & Corp. L. J. 362; Barton v. Barbour, 104 U. S. 126.

a receiver; as, for instance, when a company receiving income more than sufficient to pay the expenses of an economical management refuses to apply the surplus to the payment of a judgment or mortgage which is a lien upon its property.[8]

It has been declared that the appointment of a receiver is not a matter of right, but rests in the sound discretion of the court, and is a power to be exercised sparingly and with great caution.[9]

In some states, courts of equity are fortified in their assumption of the management of insolvent railroad and other corporations by express statutes. But, without the aid of a statute, the chancery jurisdiction of the courts is sufficient for the exercise of this authority in all instances where their interference is necessary to protect the property or to enforce the right of persons interested in it, whether creditors or stockholders.[10] "It is not unusual," said Mr. Justice Swayne, of the United States Supreme Court,[11] "for courts of equity to put receivers in charge of the railroads of companies which have fallen into financial embarrassment, and to require them to operate such roads until the difficulties are removed, or such arrangements are made that the roads can be sold with the least sacrifice of the interest of those concerned. In all such cases the receiver is the right arm of the jurisdiction invoked. As regards the statutes, we see no reason why a court of equity, in the exercise of its undoubted authority, may not accomplish all the best results intended to be secured by such legislation without its aid."

In several states it is provided by statute that in an action by a

[8] Covington. Drawbridge Co. v. Shepherd, 21 How. (U. S.) 112; and see Stevens v. Davison, 18 Gratt. (Va.) 819; 98 Am. Dec. 692. For a case justifying appointment see Putnam v. Jacksonville &c. R. Co. 61 Fed. 440.

[9] Farmers' &c. Co. v. Winona &c. R. Co. 59 Fed. 957; Farmers' &c. Co. v. Kansas City &c. R. Co. 53 Fed. 182.

[10] Stevens v. Davison 18 Gratt. (Va.) 819; 98 Am. Dec. 692.

[11] Davis v. Gray, 16 Wall. (U. S.) 203, 219. On a proper showing by a proper party on due notice, and in the exercise of a sound judicial discretion, a United States court may appoint a receiver over a railway where the company has made default in the payment of its mortgage indebtedness, or where default is imminent on account of insolvency or where the interest on the mortgage is long past due and the property is inadequate to satisfy the mortgage indebtedness or taxes have not been paid. Cole v. Philadelphia &c. R. Co. 140 Fed. 944.

mortgagee for the foreclosure of his mortgage and the sale of the mortgaged property, a receiver may be appointed where it appears that the mortgaged property is in danger of being lost, removed, or materially injured, or that the condition of the mortgage has not been performed, and that the property is probably insufficient to discharge the mortgage debt.[12]

An *ex parte* appointment of a receiver to manage the corporate business, or an *ex parte* granting of an interlocutory injunction to deprive the directors of control, is more than irregular; it is absolutely void, being entirely beyond the power of the court.[13]

§ 427. A state statute, which takes from the mortgagee the right of possession until foreclosure, governs a federal court sitting in the state, and deprives such court of the power to appoint a receiver of the rents and profits on the ground that the security is inadequate. The statute to this effect in Michigan[14] takes away from the mortgagee the right to the possession until foreclosure is completed by sale, and the sale has become absolute by confirmation. The statute, by implication, secures to the mortgagor the rents and profits pending foreclosure, and consequently an appropriation of them by the hand of a receiver for the benefit of the mortgagee would deprive the mortgagor of a substantial right.[15] The statute does not create a matter of practice merely, but rather a substantial right of property which must be recognized by the courts of the United States in administering the rights of parties to a mortgage security.[16]

[12] **California,** Codes & Stats. 1876, ch. 5, § **10,564**; **Arkansas,** Digest 1874, p. 838, § **4810**; **Kentucky,** Code of Practice 1876, § **299**; **Dakota T.,** Code of Civil Procedure 1877; § 219; **Montana, T.,** Laws 1877, p. 93; Code of Civil Procedure, § **221**; **Washington T.,** Laws 1877, p. 10; **Wyoming T.,** Compiled Laws 1877, ch. 13, § **253**, of Civil Code; **Ohio,** R. S. 1860, p. 1019. For statute authorizing appointment of receivers in **New York,** see 3 R. S. 1875, p. 511, § **244.**

See, also, Jones Mortgages, §§ **1521, 1522.**

[13] Port Huron &c. R. Co. v. St. Clair Circuit, 31 Mich. 456.

[14] Annot. St. § **7847.**

[15] Wagar v. Stone, 36 Mich. 364.

[16] Union &c. Ins. Co. v. Union Mills &c. Co. 37 Fed. 286, 292; Brine v. Insurance Co. 96 U. S. 627. In the former case, Severens, J., delivering the opinion, said: "I am aware that there are some decisions in the courts of the United States in which the principles of

But a state statute providing for the appointment of receivers under certain circumstances does not preclude the exercise of its general equity power by a federal court which acquires jurisdiction through the diverse citizenship of the parties and the amount involved in the litigation.[17]

§ 428. The appointment of a receiver is an equitable remedy, and has been said to be in effect an equitable execution.[18] Hence it follows that a receiver cannot be appointed in a suit upon a note, such proceeding being strictly an action at law.[19] This remedy is a provisional one also, and bears a similar relation to courts of equity that proceedings in attachment bear to courts of law. "The issuing of an attachment and the appointment of a receiver in a civil action are both proceedings which are merely ancillary or auxiliary to the main action. The action may be prosecuted to final judgment, either with or without such proceedings. These auxiliary proceedings are merely intended to secure the means for satisfying the final judgment in case the plaintiff should succeed in the action, and they can only be resorted to where the special circumstances exist which the law prescribes for their institution."[20]

decision are inconsistent with those of Wagner v. Stone, 36 Mich. 364, and which hold that the substantial right of the mortgagor to the rents and profits is not impaired in any legal sense by the appointment of a receiver to take them; the theory being that the hand of the court is to be regarded, not as hostile, but as holding for the mortgagor as well, and turning over his property through judicial process to the payment of his just debt, when needed to meet a deficiency. It is not needful for me to express any opinion on this divergence of views in the present case, for the doctrine of adherence to the local law in real property matters looks to the rule adopted, rather than to the reasoning which led to it, and I think that the law of the state, as declared in Wagar v. Stone, requires that it should be held here that a receiver of the rents and profits cannot be appointed in mortgage foreclosure cases upon the sole ground that the security is inadequate. Whether the court will appoint a receiver in foreclosure cases, when the property is being destroyed or wasted by the mortgagor, is an entirely different question."

[17] United States &c. Co. v. Conklin, 126 Fed. 132.

[18] Jeremy's Eq. Jur. 249.

[19] Smith v. Superior Court, 91 Cal. 348; 32 Pac. 322.

[20] Cincinnati, S. & C. R. Co. v. Sloan, 31 Ohio St. 1, 7, per White, J.

The appointment of a receiver of a railroad company in a foreclosure suit does not follow a default in the payment of interest as a matter of course, but is a matter of sound discretion with the court in view of all the circumstances of the case.[21] Although the mortgage provides that the trustee, on default of payment of either principal or interest of the bonds, may take possession of the property, yet when the aid of a court of equity is invoked it will look into the facts and exercise an equitable discretion.[22]

The proper object of a receivership is the temporary preservation of the property, and the application of the rents and profits of the road to the payment of its debts pending the foreclosure proceedings, and the court's custody of the railroad should be terminated with as little delay as practicable.[23]

When a railroad company by collusion with a creditor allows its property to go into the hands of a receiver, not for the purpose of meeting its obligations to the petitioning creditor, but for the purpose of keeping its property from other creditors, the court will, upon its own motion, upon being informed of the facts, discharge the receiver.[24]

[21] Skip v. Harwood, 3 Atk. 564; American Loan &c. Co. v. Toledo &c. R. Co. 29 Fed. 416; Raht v. Attrill, 42 Hun (N. Y.), 414. Hence the removal or appointment of a receiver is not revisable on appeal. Milwaukee &c. R. Co. v. Soutter, 154 U. S. 540; 14 Sup. Ct. 1158.

[22] Jones Mortgages, § **1516**; Williamson v. New Albany R. Co. 1 Biss. (U. S.) 198. As to general principles see Owens v. Homan, 4 H. L. Cas. 997, 1032, per Lord Cranworth; Mercantile Trust Co. v. Missouri &c. R. Co. 36 Fed. 221, 227; Hervey v. Ill. Midland R. Co. 28 Fed. 169.

[23] Taylor v. Phila. &c. R. Co. 9 Fed. 1; 7 Fed. 381; Mercantile Trust Co. v. Missouri &c. R. Co. 36 Fed. 221; 4 Railw. & Corp. L. J. 362; Blair v. St. Louis &c. R. Co. 20 Fed. 348.

[24] Sage v. Memphis &c. R. Co. 5 McCrary (U. S.), 643, 648. The application for a receiver in this case was made by a judgment creditor. His judgment was rendered by consent on the same day the receiver was appointed, without opposition, the company appearing voluntarily and waiving service. No suit had been commenced to foreclose either of the mortgages upon the road. "The court is asked," said Judge McCrary, "to stand between the company and its creditors while the company is engaged in using the earnings, not to pay its debts, but to improve its property. It is said that this policy is best for the company and its

§ 429. A railroad company cannot itself properly ask for the appointment of receivers of its property to protect it as against its creditors. Where receivers were so appointed by the Circuit Court of the United States at St. Louis at the request of the Wabash Railroad Company, and at the same time ancillary proceedings were had in Illinois, and receivers were appointed for the property in that state, creditors having mortgages covering property of the road wholly in the State of Illinois subsequently filed their bills to foreclose these mortgages in the Circuit Court of the United States for Illinois, and the court entertained jurisdiction of the suit and removed the receivers appointed at the request of the corporation.[25]

The Circuit Court at St. Louis made such an appointment upon the allegations of the railroad company that it owned a vast property, running through several states, burdened with a variety of local incumbrances and obligations, the value of which consisted largely in its being preserved in its entirety and with all its connections. The application was made two days before a default, in order to preserve the property intact and to permit the general mortgagee, when a default should actually occur, to file his bill for foreclosure and have the property sold. The mortgagee did immediately after a default file a cross-bill to foreclose the general mortgage in the same court, and also a bill in the state court for the same purpose. The railroad company removed the suit in the state court to the Circuit Court, and it was there consolidated with the suit by the cross-bill. The Circuit Court in that proceeding sustained its jurisdiction to proceed to a decree of foreclosure on the bill so filed by the mortgagor and the consolidated suit of the mortgagee. The

creditors. Whether this be so or not is for the company and its creditors to determine; it is not for the court to engage in the operation of a railroad through a receiver because the interests of the parties concerned may be thereby advanced." See, also, Overton v. Memphis &c. R. Co. 10 Fed. 866.

[25] Atkins v. Wabash &c. R. Co. 29 Fed. 161. See, in connection with this case, Central Trust Co. v. Wabash &c. R. Co. 29 Fed. 618, for instructions of the court of primary jurisdiction as to the surrender of property to the receiver appointed by the court in the Illinois circuit. The receivers appointed originally are directed to surrender control of the roads east of the Mississippi, of which the new receiver shall take possession.

proceeding has, however, been so severely and so generally criticised that the precedent is not likely to be followed.[26]

If the suit be brought, and the appointment of a receiver be asked for by mortgage trustees or bondholders, it cannot be objected that the suit was the result of a fraudulent collusion between the plaintiff and the debtor corporation, merely because the directors of the corporation knew of the intention to bring the suit, and they, or some of them, approved of the suit and of the receivership. If the suit was brought by the actual owner of bonds of the corporation, not transferred to him fictitiously, and not bought for the purpose of the suit, it is no objection to it that the debtor corporation favored it.[27]

§ 430. Upon an application for a receiver by mortgage creditors, it is generally necessary to show something more than the fact that a default has occurred in the payment of interest as for instance to show that the debtor corporation is insolvent,[28] or that ultimate loss is likely to happen to the beneficiaries under the mortgage by permitting the property to remain in the hands of its owners until the final decree and sale.[29] The appointment of a receiver is a matter within the sound discretion of the court, and the power is exercised in behalf of railway bondholders only in strong cases; and only upon its appearing that the property is insufficient to pay the debt, and that the mortgage creditors are in danger of suffering

[26] Wabash &c. R. Co. v. Central Trust Co. 23 Fed. 513. When the mortgagees filed the cross-bill, the appointment of additonal receivers was asked for; but the court refused their appointment unless it could be shown to be necessary for the protection of the rights of the parties interested under the mortgage. Wabash &c. R. Co. v. Central Trust Co. 22 Fed. 272.

[27] Brassey v. New York &c. R. Co. 22 Blatchf. (U. S.) 72.

[28] Taylor v. Philadelphia &c. R. Co. 14 Phila. (Pa.) 451; 38 Leg. Int. 73; 7 Fed. 381.

[29] Williamson v. New Albany R. Co. 1 Biss. (U. S.), 198; Union Trust Co. v. St. Louis &c. R. Co. 4 Dill. (U. S.) 114; 4 Cent. L. J. 585; Cheever v. Rutland &c. R. Co. 39 Vt. 653; Burlingame v. Parce, 12 Hun (N. Y.), 144; Dow v. Memphis &c. R. Co. 20 Fed. 260; Sage v. Memphis &c. R. Co. 5 McCrary (U. S.), 643; Overton v. Memphis &c. R. Co. 10 Fed. 866; Mercantile Trust Co. v. Missouri &c. R. Co. 36 Fed. 221; 4 Railw. & Corp. L. J. 362; Heinsheimer v. Dayton &c. R. Co. 3 Railw. & Corp. L. J. 268.

irreparable loss.[30] Urgent occasion for the appointment of a receiver to manage and operate a railroad should be shown before the court exercises its authority in this way. Mr. Justice Miller, of the Supreme Court of the United States, in reference to the exigencies which justify the exercise of this prerogative of a court of chancery, said[31] that the appointment of receivers by a court to manage the affairs of a long line of railroad, continued through five or six years, is one of those judicial powers the exercise of which can only be justified by the pressure of an absolute necessity.

Such a necessity did not exist in the case before him: "The idea of appointing or continuing a receiver for the purpose of taking ninety-five miles of railroad from its lawful owners, which is earning a gross revenue of $800,000 per annum, to enforce the payment of a judgment of $16,000, the lien of which is seriously controverted, is so repugnant to all our ideas of judicial proceedings that we cannot argue the question. If the creditor has a valid judgment, the usual modes of enforcing that judgment are open to him, both at law and in chancery; but the extraordinary proceeding of taking millions of dollars' worth of property, of such peculiar character as railroad property is, from its rightful possessors, as one of the usual means of collecting such a comparatively small debt, can find no countenance in this court."

To the same effect Mr. Justice Barrett, of the Supreme Court of Vermont, says:[32] "It is a fundamental element in any idea of a receivership under the law that there should be such a necessity for

[30] Pullan v. Cincinnati &c. R. Co. 4 Biss. (U. S.) 35; Milwaukee &c. R. Co. v. Soutter, 2 Wall. (U. S.) 510, 523; Vose v. Reed, 1 Woods (U. S.), 647; Frisbee v. Timanus, 12 Fla. 300; State v. Jacksonville &c. R. Co. 15 Fla. 201, 286; Cincinnati &c. R. Co. v. Sloan, 31 Ohio St. 1; Kelly v. Ala. &c. R. Co. 58 Ala. 489; Hayward v. Lincoln, 64 Wis. 639; Baily v. Smith, 14 Ohio St. 396; 84 Am. Dec. 385n; M'George v. Big Stone Gap Imp. Co. 57 Fed. Rep. 262.

[31] Milwaukee &c. R. Co. v. Soutter, 2 Wall. (U. S.) 510, 523; and see Delaware &c. R. Co. v. Erie R. Co. 21 N. J. Eq. 298.

[32] Vermont &c. R. Co. v. Vermont Central R. Co. 50 Vt. 500; 14 Am. Railw. 497, 544. Where a street railway company was without officers, the trustee under the mortgage had refused to act and signified his intention to resign, and proceedings to forfeit the franchise had been commenced, an application for a receiver by a bondholder was properly made. Ralph v. Wisner, 100 Mich. 164; 58 N. W. 837.

it as to render it the duty of the court, in the exercise of its judicial judgment upon the case presented, to exert its prerogative in that behalf, and create the receivership in the discharge of that duty. It is never to be created because it will do no harm, nor even because it will do good, unless the exigency be such as to impose the duty upon the court."

§ 431. But a mere default is a sufficient ground for the appointment of a receiver where the mortgage in terms covers the income and profits of the mortgaged property, and provides that upon default in the payment of interest the bondholders or their trustees shall be entitled to have the income and profits of the trust property applied to the payment of their debt. In such case the appointment should not be denied because it is not shown that the property mortgaged is insufficient to pay the mortgage debt, or that it is in jeopardy, or that the company is insolvent, or because the amount due on some of the bonds is in dispute.[33]

If mortgage trustees are authorized by the mortgage to take possession upon a default and refuse to do so, the bondholders are entitled to have a receiver appointed for their protection.[34]

§ 432. Ordinarily a receiver will not be appointed in behalf of a mortgagee until a right of foreclosure exists, even when there has been a default in the payment of interest, if it appears that there is a fair and reasonable claim on the part of the corporation growing out of contemporaneous contracts, that the time of payment has been extended, or that the plaintiffs are precluded from relying on the default.[35]

[33] Allen v. Dallas &c. R. Co. 3 Woods (U. S.), 316, 326; Whitehead v. Wooten, 43 Miss. 523; Morrison v. Buckner, 1 Hempst. (U. S.) 442; American Bridge Co. v. Heidelbach, 94 U. S. 798. Mr. Justice Woods, in Allen v. Dallas &c. R. Co. 3 Woods (U. S.) 316, 326, said: "The rights of holders of negotiable bonds issued by a railroad company and secured by a mortgage on its property are not to be measured by the same rules as are applied to an ordinary mortgage of a farm or house and lot to secure one or two notes held by one mortgagee."

[34] Warner v. Rising Fawn Iron Co. 3 Woods (U. S.), 514.

[35] American Loan &c. Co. v. Toledo &c. R. Co. 29 Fed. 416; Rogers v. Southern Pine Lumber Co. 21 Tex. Civ. App. 48; 51 S. W. 26.

In such case the court will not generally disturb the possession of the mortgagor until the right of foreclosure has been established at the hearing.

But it has been declared that, even before default, the mortgagee has a right to ask for the appointment of a receiver to prevent the property from being wasted or its value impaired, as where the mortgagor's franchise to pipe water through city streets has been wrongfully annulled by the city.[36]

§ 433. Where, however, a default is imminent and manifestly inevitable, though none has taken place, a receiver of a railroad company may be appointed on the application of a mortgage bondholder, in order to prevent the breaking up and destruction of its business, and to protect the property against attachments and execution in favor of other creditors.[37] "It is true, that, in general, a receivership is ancillary or incidental to the main purpose of the bill; but it does not follow, that, where a case is presented which demands the relief which can be best given by a receivership, such relief must be refused because the time has not arrived when other substantial relief can be asked."[38]

§ 434. A judgment creditor may have a receiver appointed to protect his interests, in a suit in behalf of himself alone, without suing in behalf of all the creditors of the company, or of such as might come in and contribute to the expense of the litigation.[39] He need not sue out an execution upon his judgment, and have a return of *nulla bona,* when this would be a useless ceremony and no objection is taken to his failure to do so. It is the privilege of a judg-

[36] Farmers' &c. Co. v. Meridan Waterworks Co. 139 Fed. 658.

[37] Brassey v. New York &c. R. Co. 22 Blatchf. (U. S.) 72, 79; 19 Fed. 663; Long Dock Co. v. Mallery, 12 N. J. Eq. 431; Ralph v. Shiawassee Cir. Judge, 100 Mich. 164; 58 N. W. 837; Thompson v. Natchez Water Co. 68 Miss. 423; 9 So. 82, citing text, and applying the same principles to a water company.

[38] Brassey v. New York &c. R. Co. per Shipman, J., 22 Blatchf. (U. S.) 72, 79; 19 Fed. 663.

[39] Sage v. Memphis &c. R. Co. 125 U. S. 361; 8 Sup. Ct. 887; 3 Railw. & Corp. L. J. 468; Union Trust Co. v. Illinois R. Co. 117 U. S. 434; 6 Sup. Ct. 809; Chicago &c. R. Co. v. Kenney, 159 Ind. 72; 62 N. E. 26.

ment creditor to sue in his own behalf; and it is within the power of the court, for his protection, to place the property of the debtor company in the hands of a receiver, for administration under its orders. The creditor is not entitled to have the property of a railroad company put in the hands of a receiver, as matter of right, merely because of its failure to pay its debts. Whether a receiver shall be appointed is a matter of discretion to be exercised with caution in the case of *quasi* public corporations operating a highway, and always with reference to the special circumstances of each case as it arises.[40]

In general it may be said that a creditor at large can confer no jurisdiction upon a court to appoint a receiver, for the statutes generally confer no such jurisdiction, and no rule of equity sustains it.[41] Thus a receiver should not be appointed in an action by a simple contract creditor to prevent a corporation from fraudulently disposing of its property.[42] However, an appointment made on the application of a creditor who has not reduced his claim to judgment is not absolutely void. It does not follow that the court is wholly without jurisdiction of the cause, and all its proceedings void; nor is jurisdiction lost by payment of the demand of the plaintiff in the bill. The general character and scope of the bill being of equitable cognizance, the jurisdiction of the court does not depend upon technical sufficiency or fullness of averment.[43]

Under the Indiana statute it has been held that a shareholder in a corporation, who is a creditor as well, can obtain the appointment of a receiver of the corporation where the conditions essential to such proceedings exist. But a receiver will not be appointed on the application of any shareholder when the sole basis is the disaffection of such stockholder.[44]

[40] Sage v. Memphis &c. R. Co. per Harlan, J., 125 U. S. 361; 8 Sup. Ct. 887; 3 Railw. & Corp. L. J. 468.

[41] Lehigh &c. Co. v. Central R. Co. 43 Hun (N. Y.), 546. In Woerishoffer v. North River C. Co. 99 N. Y. 398; 2 N. E. 47; 34 Hun (N. Y.), 634; 6 Civ. Pro. 113, the plaintiff was a stockholder as well as creditor.

[42] International Trust Co. v. United Coal Co. 27 Colo. 246; 60 Pac. 621; 83 Am. St. 59n.

[43] Farmers' &c. Co. v. Centralia &c. R. Co. 96 Fed. 636.

[44] Supreme Sitting of I. H. v. Baker, 134 Ind. 293; 33 N. E. 1128; 20 L. R. A. 210n.

§ 435. Mismanagement alone of the property by the mortgagor is no ground for the appointment of a receiver. A court of equity may interfere by injunction to prevent a waste or destruction of the mortgaged property before the conditions of the instrument have been broken, and a right to foreclose has accrued; but the court will not appoint a receiver to manage the property until the mortgage can be foreclosed. Much less will mere disagreements of the different parties in interest as to the management of the property furnish a foundation for the appointment of a receiver. That can be done only as an incident to some relief falling within the jurisdiction of the court in relation to the contracts of the parties. The appointment of a receiver simply to manage the property is not within the power of a court of equity.[45]

A receiver will not be appointed to protect mortgaged property from waste or destruction unless the danger of an impairment of the security is imminent.[46] The mere disuse of a manufacturing plant under an agreement with other manufacturers to restrict production, though attended with the decay and dilapidation inseparable from disuse, is not such destruction or waste as will entitle the mortgagee to ask for a receiver.[47]

The execution of a lease in excess of corporate powers does not warrant the appointment of a receiver where no other mismanagement of the property is shown.[48]

§ 436. A receiver will not be appointed when the mortgagee has a complete and adequate remedy at law in respect of the matters on account of which the appointment of a receiver is sought. Thus, if the mortgage authorizes the trustee upon a default to take possession and to collect all tolls, rents, and profits of the mortgaged road, a receiver will not be appointed for the mere purpose of obtaining possession pending a foreclosure suit, when it is not shown that

[45] American &c. Co. v. Toledo &c. R. Co. 29 Fed. 416. See Mason v. Supreme Court &c. 77 Md. 483; 27 Atl. 171; 39 Am. St. 433.

[46] Pullan v. Cincinnati &c. R. Co. 4 Biss. (U. S.) 35, 47; Morrison v. Buckner, Hempst. (U. S.) 442.

[47] Union Mut. &c. Co. v. Union &c. Co. 37 Fed. 286.

[48] New Albany Waterworks v. Louisville Banking Co. 122 Fed. 776.

the trustee has attempted to obtain possession of the property by entry or by suit at law.[49]

If the trustees assume to act, relying only upon the powers contained in the mortgage, they must show that the terms of the power have been strictly complied with. But simply as the legal owners of the mortgage, they have the same right as any other suitor to come into court and ask for the protection of the property by the appointment of a receiver. A trustee can always come into a court of equity for aid or instruction in conserving his trust.[50]

§ 437. **Whether a receiver should be appointed is a question often attended with difficulty,** and to answer it properly is one of the most embarassing duties a court of chancery has to perform. This was the remark of Judge Drummond in a cause before the Circuit Court of the United States, which presented peculiar and unusual difficulties. A bill had originally been filed by a mortgage trustee for a foreclosure of the mortgage and a sale of the property. After the case had been pending some time, a compromise agreement was made for a reorganization of the company, and a decree was entered by consent ratifying the agreement. This contemplated, with other things, a surrender of a portion of the bonds and their conversion into stock; and, of course, could be made effectual only by the voluntary action of all the bondholders. The property was placed in the hands of a trustee to carry out the orders of the court. Various interlocutory orders were made in the case from time to time. After some years the trustee and some of the bondholders applied to a state court for a foreclosure of the same mortgages, and that court appointed a receiver and decreed a sale, which was completed and the road delivered to the purchasers. In this situation of affairs a bondholder, who had not come into the compromise agreement, applied to the Circuit Court for the appointment of a receiver, and, that court having decided that it had not lost control of the subject matter of the suit, and that the interference of the

[49] Rice v. St. Paul &c. R. Co. 24 Minn. 464. See, also, St. Louis &c. R. Co. v. Dewees, 23 Fed. 519; Henry v. Travellers' &c. Co. 16 Colo. 179; 28 Pac. 318, citing text. See Minneapolis Land Co. v. McMillan, 79 Minn. 287; 82 N. W. 591.

[50] Phinizy v. Augusta &c. R. Co. 56 Fed. 273.

state court in dealing with and disposing of property at the time within the jurisdiction of the Circuit Court was unauthorized, the only inquiry remaining was, therefore, whether a receiver should be appointed pending the settlement of the rights of the parties by the court. The company was insolvent; the former trustee was dead; having made no reports to the court of the manner in which he had performed his trust; the new trustee had been a party to the litigation in the state courts, and had sought to dismiss the proceedings in the Circuit Court. The parties then in possession of the road were acting in hostility to the decrees of the Circuit Court, and the interests therein adjudicated. The court, therefore, deemed it impossible to give any relief to the petitioner and others in similar relations, unless the court should take possession of the property; and a receiver was accordingly appointed.[51]

§ 438. That a receiver will not be appointed upon the application of a mortgagee, as a matter of course, upon a default, is illustrated by the case of the St. Louis, Iron Mountain, and Southern Railroad Company. This company owned its existence to the consolidation of several other companies, which had largely built the road before they were absorbed in the present corporation.[52] Each of the four companies which became so consolidated was already heavily mortgaged, and the new corporation executed a mortgage of its property and income, and franchises, for $28,000,000, chiefly for the purpose of taking up the existing mortgages. Only about $2,000,000, of the old bonds were exchanged for the new, and it was soon apparent that the company could not complete its road and pay the interest on its bonded debt, and consequently an arrangement was made by which the interest coupons on all the bonds for two years were funded. During this time the road was completed, the floating debt considerably reduced, and the income of the road each year had increased; but the company was unable to pay in full the coupons first maturing after this period. In this condition of things the agents of Baring Bros. & Co., who were very large creditors of the company, proposed that half of each coupon should be paid,

[51] Bill v. New Albany R. Co. 2 Biss. (U. S.) 390.

[52] Union Trust Co. v. St. Louis &c. R. Co. 4 Dill. (U. S.) 114; 4 Cent. L. J. 585.

relying on the leniency of the holders for such extension of time for the other half as should be nescessary. This plan was accepted and acted upon by nearly all of the creditors; but the above named creditors had apparently changed their purpose, though no notice of such change appears to have been given; for their coupons were presented for payment, and payment of half of each having been tendered, it was refused, and a bill for foreclosure was immediately filed, with an application for the appointment of a receiver. The bill alleged that the road was insolvent; that there was danger that the prior divisional mortgages would be foreclosed on the separate parts of the road, and the road, which was valuable as a whole, would be rendered no security at all for the debt of the complainants; and that the income of the road which should be appropriated to the payment of the interest would be diverted to the payment of the floating debt of the company, on part of which the directors of the company were personally liable.

These allegations were controverted by the answer, which claimed that the road was yielding a net income of six per cent. on $28,000,000, while its entire debt was more than $2,000,000 less than that sum; that the income had been steadily increasing for several years; and that besides the road, its rolling stock and appurtenances, the company owned lands apart from the road, but subject to the mortgage, of the value of $8,000,000.

It was insisted in behalf of the complainants, that the failure to pay the interest, and to deliver possession of the road on demand, left no discretion in the court to refuse to place the road in the hands of a receiver; that because the income of the road was pledged for the payment of the bonds, and the trustees were authorized, on failure to pay any instalment of interest, to take possession, the court was required, as a matter of law, without regard to the resources of the company, and without reference to any showing of danger of ultimate loss to the bondholders, or of any serious delay of payment, to take possession of the property of the company.

Mr. Justice Miller, delivering the opinion of the Circuit Court of the United States, commenting upon the bill of the complainants, said that it did not ask for any specific performance of the contract to deliver possession of the road to the mortgagees upon default; that it abandoned the right of foreclosure by the power of sale given

to the trustees, and sought the safer mode of sale in chancery; that although the surest mode of securing the income of the road may be through a receiver, yet the income is no more mortgaged than the visible property and franchises of the company, and, unless there is danger of loss to the bondholders, there is no more reason why the income rather than other property of the company should be sequestered. It is also in the power of the court, without appointing a receiver, to require of the defendant the rendering of an account of the income, and, after payment of the necessary expenses, to pay so much as rightfully should be paid upon the debt secured by the mortgage.

The court, while admitting the right of the complainants to foreclose the mortgage, declared that the appointment of a receiver depended upon the danger of ultimate loss to the bondholders by permitting the property to remain in the possession of its owners until the final decree and sale; that the appointment is a matter of discretion with the court in view of all the circumstances of the case; and that the facts established in this case did not show any such danger of loss to the bondholders as to justify the court in turning over to them, or to a receiver, the possession of the road and property embraced in the mortgage.

§ 439. **A receiver will not be appointed against the wishes and interests of a great majority of the bondholders,** upon the application of a very small minority of bondholders, so long as the property is honestly and successfully managed; but will leave the complainants to their remedy of a decree of sale in accordance with the law and practice in an ordinary foreclosure suit.[53] In such case the equities of the great body of the creditors and stockholders of a railroad company, whose interests would be imperilled by the appointment of a receiver, will be respected in the exercise of a discretionary power of the court to interfere by taking possession of the property, and the complainants will be left to their technical right of foreclosure in the usual course of proceedings. Especially will the court decline to interfere in this way when the result of such interference would be to overturn a funding scheme, which all but a small fraction of the bondholders have agreed upon and are successfully car-

[53] Romare v. Broken Arrow &c. Co. 114 Fed. 194.

rying out, and to break up a long line of railroad into several fragments upon which the mortgages were originally given, to the manifest injury of the whole property.

These equities of the great body of the mortgage creditors of a railroad company are well considered and applied by Mr. Justice Harlan in the recent case of the Wabash Railway Company, before the Circuit Court of the United States for the Seventh Circuit.[54] Each of the six companies originally owning this line of road had at different times, from 1853 to 1869, executed a first mortgage of its own road, the aggregate of these first mortgages being $9,400,000. Second mortgages to the amount of $5,000,000 were executed by several of the original divisions of the road. Upon a consolidation of five of the original companies a consolidated mortgage was executed, and finally, in 1873, upon a further consolidation with these companies of the sixth company, another mortgage, known as the gold mortgage, was executed. Under the latter mortgage there was a foreclosure sale in 1876; whereupon the present Wabash Railway Company was organized from the stockholders of the old company, who put in further capital to the amount of $1,600,000. A further mortgage was executed by the new company in 1877; and furthermore, a funding scheme was proposed, and was agreed to by holders of more than four-fifths of all the mortgage debts. The main feature of this scheme was the funding of the past-due coupons and those maturing so far ahead as November 1, 1878, and issuing therefor scrip certificates running until the maturity of the bonds from which the coupons were detached, bearing interest at seven per cent. annually, such arrangement not to impair the liens of the bondholders under their respective mortgages. Provision was also made for a sinking fund. Holders of bonds to the amount of nearly $100,000, in 1878, brought a foreclosure suit and applied for the appointment of a receiver. Mr. Justice Harlan, denying the application for a receiver, said: "The court cannot, in deference to the mere technical rights of a very small minority of bondholders, lay its hand upon a railroad over six hundred miles in length, running through three great states, and thereby imperil, if not destroy, the interests of those whose rights are entitled to equal consideration with those of the complainant and his colleagues. If the present management

[54] Tysen v. Wabash R. Co. 8 Biss. (U. S.) 247, 258.

of the road were guilty of any fraud or dishonest practice in their control of this property, I should feel differently. While there are differences between them and some of the bondholders as to certain matters connected with the discharge of the company's obligations, those differences do not involve the integrity of those operating the railroad. The court is disposed to recognize the absolute necessity of large discretion in the management of such vast property, and in the distribution of the net income arising therefrom; and it is unwilling, for the present, at least, to make honest differences as to such matters the basis for its interference by the appointment of a receiver."

§ 440. In a case where it was shown that no interest had been paid on the first mortgage bonds of a railroad company for about ten years, and that the road had in the mean time changed hands once or twice, the court regarded these facts alone as raising a suspicion that the owners of the road had been very unfortunate, or very reckless, or very unmindful of their duty, and as alone affording a very strong ground for the appointment of a receiver on the motion of the mortgagee.[55] Another important fact established in the case was, that the mortgage trustee and some of the bondholders, on several occasions, applied to the president of the company for leave to examine their records, with a view to ascertaining the amount of the company's income and to the disposition made of it, and the application was evaded or denied. In view of the withholding of such necessary and proper information, the court applied the maxim, *Omnia praesumuntur contra spoliatorem.*

In this case the defendant attempted to excuse the non-payment of interest upon the ground that the company had been obliged to provide for other roads with which they had in some way become consolidated; in constructing additions to their road, and in purchasing rolling stock and equipping a long line of road; for all of which purposes a very large expenditure in the aggregate had been made. But the court said that even honest inability to pay a debt

[55] Pullan v. Cincinnati &c. R. Co. 4 Biss. (U. S.) 35, 47. See, also, Mercantile Trust Co. v. Missouri &c. R. Co. 36 Fed. 221; 4 Railw. & Corp. L. J. 362; Stewart v. Chesapeake &c. Canal Co. 4 Hughes (U. S.), 47.

is a poor excuse when one is sued for it; and that the fact that the defendant company had burdened itself with a vast expenditure and indebtedness subsequently to the mortgage, instead of being any reason why a receiver should not be appointed, was rather one reason for such appointment, inasmuch as the company, by assuming such burdens, was becoming less and less able to pay the interest upon the mortgage. "But the most remarkable feature in the answer," said Judge McDonald, giving the decision of the court, "as it seems to me, is, that it does not, that I can see, present any feasible scheme for paying this interest at all. Indeed, so far as appears from the answer, it does not seem that the interest will ever be paid voluntarily. A strong desire is evinced to extend the road and raise vast sums for equipping it; but no corresponding anxiety is shown to do anything for the first mortgage bondholders. The answer evidently evinces a design to postpone this matter till the very last. Under all the circumstances, I think the appointment of a receiver would be very proper, if the bill had averred that the mortgaged property was not a sufficient security for the debt; and that without a receiver the bondholders are in danger of irreparable injury. I suppose that in no case of a mortgage ought a court of chancery to appoint a receiver if the mortgaged property is of such value as to render it clear that, on a foreclosure and sale, the debt could all be made. In the present case, the mortgaged property would probably not bring so much on sale." In the case before the court the mortgage covered the earnings of one section of a road, which was one-fourth part in length of the whole road, and a receiver was appointed whose duty it was made to examine the books and affairs of the road, to ascertain its net earnings monthly, and receive one-fourth part of the net earnings of the whole line, and pay this into court for the use of the bondholders. The company and its officers were ordered to give the receiver all proper facilities for this examination, and to render full and fair monthly statements to the receiver under oath, and pay over to him every month a fourth part of the net proceeds.

In a case before Judge McLean, in the Circuit Court of the United States,[56] it appeared on a motion for a receiver in a similar case that the defendant had failed to pay the semi-annual interest which

[56] Williamson v. New Albany R. Co. 1 Biss. (U. S.) 198.

had fallen due within six months of the time of the filing of the bill; and principally, if not solely, for that single and recent failure, the court, while overruling the motion for a receiver, did what was nearly equivalent to appointing one, in placing the road so far under the control of the court as to require the company to make monthly reports of the net income of the road, and to pay a certain proportion of it into court every month for the use of the bondholders.

§ 440a. **That suit for a receivership has been brought by minority stockholders,** and there is danger of a dissipation of the security of an outstanding mortgage, is a ground upon which mortgage bondholders may apply for the appointment of a receiver, there being a default in the payment of interest on the mortgage bonds.[57]

§ 441. **That the mortgaged property is liable to be seized on execution** and sold piecemeal, and the security of the mortgage creditors destroyed, has been regarded as ground for the appointment of a receiver. It is true that the seizure of property which is security for the mortgage debts may be restrained by injunction, but it might be necessary to issue as many injunctions as there are creditors.[58] But it is quite doubtful if the appointment of a receiver in such a case would come within the general equity powers of a court of chancery. Even the additional fact that the insolvent corporation was about to execute a lease for a long term of years to an attaching creditor, at a rental which would not pay the interest on its indebtedness, has been held to be no ground for an injunction restraining the corporation from further prosecuting its business, and for the appointment of receivers. The court cannot restrain a corporation from making a disposition of its property which is permitted by the common law, unless fraud or a breach of trust is shown.

§ 441a. **The conduct of the officers of a corporation may be such as to require the appointment of a receiver** to take from them the

[57] Pennsylvania Co. v. Jacksonville &c. R. Co. 55 Fed. 131.

[58] South Carolina Railroad, In re, before Judge Bond of the Fourth Circuit, 11 Chicago Legal News, 8; Sage v. Memphis &c. R. Co. 125 U. S. 361; 8 Sup. Ct. 887.

[59] Pond v. Framingham &c. R. Co. 130 Mass. 194.

control of the company's affairs. Thus the court will appoint a receiver upon the application of general creditors of a corporation, whose directors have unlawfully and fraudulently executed a mortgage of its property to secure its stockholders, the company being insolvent, and it being necessary to preserve its property pending the litigation.[60]

A receiver will be appointed upon allegations of gross acts of fraud on the part of the officers of a railroad company by whom its property is likely to be squandered and embezzled. The court in such case will act upon the application of bondholders, of creditors, or of stockholders. The officers of the Memphis, El Paso and Pacific Railroad Company, a corporation of Texas, were enjoined, and a receiver of its property appointed, upon a bill filed by a stockholder, a bondholder, and the trustees for bondholders, under the mortgages of the company, on behalf of themselves and all other stockholders, creditors, and bondholders of the company.[61] An abuse of the corporate franchise, aside from the insolvency of the corporation, may be ground for such interference.[62]

Insolvency of a corporation, coupled with gross mismanagement of its affairs by its board of directors, justifies the appointment of a receiver by a court of equity independent of any statutory power.[63]

§ 442. The application of the income of a road to completing and operating it is not a misapplication of the funds of the road which calls for the appointment of a receiver, especially when so made with the consent and by the advice of a large number of the bondholders. In a case before the Circuit Court of the United States for the District of Indiana,[64] Mr. Justice McLean refused to appoint a receiver in such a case, having regard not only to the interest of the bondholders, but also to the general creditors of the company, who were deemed to be entitled to some indulgence in the payment of the deferred interest, because the completion of the road for which

[60] Avery v. Blees Mfg. Co. 27 N. J. Eq. 412.

[61] Forbes v. Memphis &c. R. Co. 2 Woods (U. S.) 323.

[62] Rochester v. Bronson, 41 How. Pr. (N. Y.) 78.

[63] United States S. Co. v. Conklin, 126 Fed. 132.

[64] Williamson v. New Albany R. Co. 1 Biss. (U. S.) 198, 208.

the floating debt was incurred had added much to the value of the mortgage security, and had increased the profits of the road; and especially as the work was done on the recommendation of the mortgage trustee who sought the appointment of a receiver. "No change of agency could increase, I am convinced, the efficiency of that already employed on the road. A sale of the property would, in all probability, sacrifice the stock of the road, amounting to between two and three millions of dollars, and more than half, if not two-thirds, of the property of the bondholders. It might enable some one or more persons to purchase the road at an almost nominal consideration. These consequences, I admit, are not to stand in the way of an equitable right, enforced under circumstances of fairness and justice. But if such results may be avoided by a short postponement of the interest, and under a prospect of a speedy payment, I hold myself authorized to do so, under the facts above stated. But I will afford to the bondholders every reasonable assurance that can be required. I will admit an order to be entered that the motion of the complainant for the appointment of a receiver be denied, and that the said company, from and after the first day of January next, set aside one-half of the net earnings of the road for the payment of the interest of the bonded debt of said company, the other half to be applied to the payment of the floating debt of the company, a report of the gross and net earnings to be made to the court monthly." This order was not to be understood as preventing a renewal of the motion for a receiver upon any new statement of facts.

§ 443. **Refusal of trustees to perform the trust.**—It has already been noticed that the usual ground of application for the appointment of a receiver of a railway, in behalf of bondholders, is that the mortgagor is insolvent and the property inadequate security for the mortgage debt. But there are other grounds upon which the courts will exercise this power, aside from any apprehended loss to the persons secured. The refusal of the trustees under the mortgage deed to perform the trust, or their misconduct in the performance of it, is sufficient ground for the interference of the court, upon the application of the bondholders, or of any considerable part of them. Thus, upon a default in the payment of interest, if the trustees, without good reason, refuse to take possession of the property and sell

it in accordance with the provisions of the mortgage deed, the court will require them to execute the trust, or will appoint a receiver.[65]

Where the mortgage trustees, for more than five months after notice to them by a majority of the bondholders, and request by them to proceed to execute the trust by taking possession and selling the property, neglected to take any steps towards the execution of the trust, although the deed of trust made it their duty to do so, the bondholders have a clear right to apply to the court to compel the trustees to act, or to appoint some one who will. This right is independent of any probable deficiency of the trust property to pay the debts secured by the deed of trust. The application for a receiver in such a case is simply a demand by the beneficiaries of the deed that the trust be executed according to its terms.[66]

The appointment of a receiver on the application of bondholders upon the foreclosure of a trust deed is warranted when it is shown that the trustee is insolvent, occupies an adverse position to the bondholders, and has been guilty of fraud.[67]

§ 444. **A receiver may in some cases be appointed merely for the purpose of securing the profits** accruing from the use of the property, without any ultimate purpose of obtaining assets by a sale of the property, as, for instance, when the security provided for does not give the creditor any right to sell the property itself, but merely a right to take it into possession and use it until the claim is satisfied from the net profits. In such case the creditor may be unable, without the assistance of the court, to obtain and hold possession of the property, especially when this is a long line of railroad with its appurtenances; and the creditor himself generally seeks the aid of a receivership, and the court as generally grants such aid. But even when the creditor does not seek this aid, but merely to be put in possession of the income of a railroad which is the stipulated security, the court may, in behalf of the debtor, decline to put the creditor into the personal management of a road, for fear that such possession once gained by the creditor may be continued, through his mis-

[65] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409; Jenkins v. Jenkins, 1 Paige (N. Y. Ch.), 243.

[66] Per Judge Woods, in Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409.

[67] Clay v. Selah Valley Irr. Co. 14 Wash. 543; 45 Pac. 141.

management of the property or otherwise, longer than would be necessary if the property were managed by a disinterested and efficient officer of the court, who would be amenable to the court for a proper administration of the road, a proper accounting for the proceeds, and a proper application of them to the payment of the debt secured. In such cases a receivership is often indispensable to the enforcement of the lien, and to the protection at the same time of the rights and interests of all parties interested in the property.

Thus, where property has been turned over to the mortgagee to collect the income and apply it to the mortgage debt, mismanagement by the mortgagee furnishes a ground upon which the mortgagor may secure the appointment of a receiver.[68]

§ 445. A receiver will be appointed to collect and disburse the income pending a sale under a decree, if certain of the bondholders are in possession, to the exclusion of other bondholders, to whom they are hostile in interest, unless the interval between the decree and sale will be very brief.[69]

§ 446. Appointment of receiver of insolvent corporation to sell its property.—In New Jersey it is provided by statute that when the property of an insolvent corporation in the hands of a receiver is incumbered with mortgages or other liens, the legality of which is brought in question, and the property is of a character materially to deteriorate pending the litigation, the Court of Chancery may order the receiver to sell it clear of incumbrances at public or private sale for the best price that can be obtained, bringing the money into court, there to remain subject to the same liens and equities of all parties in interest as was the property before it was sold, and to be disposed of as the court may by its decree direct.[70] Under this statute a sale may be ordered, although the litigation be not distinctly

[68] Sibson v. Hamilton &c. Co. 21 Wash. 362; 58 Pac. 219.

[69] Benedict v. St. Joseph &c. R. Co. 19 Fed. 173.

[70] 1 R. S. 1877, p. 192, § 84; Nix. Dig. Supplement, 409; Act of March 13, 1866. As regards the insolvency see Nat. Bank v. Sprague, 21 N. J. Eq. 530, 538; Sewell v. Cape May &c. R. Co. 50 N. J. 717; 25 Atl. 929; 30 Am. & Eng. R. Cas. 155. Nothing short of present actual insolvency will warrant the appointment of a receiver to wind up a corporation. Edison v. Edison U. P. Co. 52 N. J. 620; 29 Atl. 195.

and solely as to the legality or validity of the incumbrances. It is sufficient that there is a dispute as to the extent to which a mortgage is an incumbrance,[71] or that its priority is assailed;[72] and it is not essential that the dispute shall appear from the pleadings of the parties, but it may be shown by the petition of the receiver.[73] As to the mode of sale, the receiver, under this statute, should be vested with large discretionary powers.[74]

The object of the legislature in these acts is declared to be the prevention of loss by the depreciation in value of the property pending protracted litigation. The mischief and the remedy are plainly apparent upon the face of the act. It was not intended to confine the remedy to mischief arising from litigation of any particular character, but to all litigation between incumbrancers respecting the validity, extent, or priority of their liens. The act must be so construed as to suppress the mischief and advance the remedy.[75]

It has been urged that the franchises of a corporation are not within the words of this act; that they are not property, and therefore that they cannot be sold by virtue of the act. Technically speaking, franchises are property, but they are property of a peculiar character arising only from legislative grant, and are not, in ordinary cases, subject to execution or to sale and transfer, even in payment of the debts of the corporation, without the assent or authority of the legislature. But construing the original and supplementary acts together, it is apparent that the chancellor has discretionary power to order a sale of the franchises as well as of the property of insolvent corporations, and that he may order a sale of both clear of incumbrances.[76]

As between trustees for first mortgage bondholders of an insolvent railroad company who are seeking to foreclose an overdue mortgage upon property of far less value than the amount of the debt, and a receiver who applies under this act for an order of sale of the property and franchises free from the lien of the incumbrances, the trus-

[71] Middleton v. New Jersey R. Co. 26 N. J. Eq. 269, 270.

[72] Emmons v. Pottery Co. (N. J.) 16 Atl. 158.

[73] Emmons v. Pottery Co. (N. J.) 16 Atl. 158.

[74] Potts v. New Jersey Arms &c. Co. 17 N. J. Eq. 395; Emmons v. Pottery Co. (N. J.) 16 Atl. 158.

[75] Randolph v. Larned, 27 N. J. Eq. 557.

[76] Randolph v. Larned, 27 N. J. Eq. 557.

tees are entitled to the possession of the property, and to apply the income, if any, to the reduction of their debt, and a court of equity will not interfere with such right, unless the equities of other parties are likely to be prejudiced. The validity and extent of the mortgage can be best determined in the foreclosure suit, and the property can be sold to better advantage after these questions are disposed of. In such a case no one but the mortgagees are interested, and if they wish to delay the sale pending the litigation, there is no reason why their prayer should not be granted.[77]

§ 447. Appointment of receiver to operate road.—It is also provided by statute in New Jersey[78] that if any railroad company fails to run daily trains on any part of its road for the space of ten days, then the chancellor, upon petition of any citizens of the state, and due proof of the facts, shall speedily appoint a receiver, who by order of the chancellor is empowered and required to take possession of all the real and personal property of such company, and to operate the road and transact its ordinary business in the transportation of freight and passengers for such time as the chancellor may direct; and all expenses incurred thereby are made a first lien on all the earnings thereof prior to any other claim, and the surplus, if any, is distributed as the chancellor may direct.

This act is the creature of public considerations altogether. When a receiver has been appointed under it in behalf of the public, the possession of the road, when given up, should be returned to the

[77] Randolph v. Larned, 27 N. J. Eq. 557.

[78] Laws 1874, ch. 27, § 1; 2 R. S. 1877, p. 943. See, also, 1 R. S. 1877, p. 196, § 106.

The power conferred upon a receiver by this statute to operate the road is not conferred upon him as an independent person, but as an officer of the court. The power is to be exercised for the benefit of the public. The court may control the operation of the road, and may direct the making of contracts, or may authorize the receiver to make them. Contracts made by such receiver on his own discretion may be enforced against the trust fund; but one who contracts with the receiver does so with the knowledge that he can obtain redress only by obtaining permission of the court that made the appointment to sue at law or by petition in the chancery court, and in either case satisfying that court that the claim is well founded. Vanderbilt v. Central R. Co. 43 N. J. Eq. 669.

company from which it was taken. The right of possession as between two companies, each claiming such right, cannot be determined upon the petition of either. A claim of paramount right of possession by a company other than that from whose possession the road was taken by force of a proceeding of this kind is a matter to be settled between the opposing parties in due course of law upon the surrender of the road to the company from which it was taken.[79]

When a receiver has been appointed under this act, his proceedings will not be stayed to allow an inquiry into the causes of the company's failure to operate the road, and proof that such failure was not attributable to the fault of the company, but to the act of lawless persons, by whom the rolling stock was by force taken out of their possession and withheld from them with a view to compelling the payment of wages due from another company. By the terms of the statute it is obligatory upon the court to take possession of a road and operate it, in order to relieve the public from the effect and consequences of the apparent dereliction of duty on the part of the owners. Whenever the exigency shall have ceased, the court will restore the road to the owners. But until the railroad company satisfies the court of its willingness and ability to operate the road, the receiver will be continued in possession. The public necessity is paramount.[80]

§ 447a. **A railway company may properly be put in the hands of a receiver after a judgment forfeiting its charter obtained by the state.** If in such case a mortgage trustee intervenes asking foreclosure, the funds in the hands of the receiver belong to general creditors. The mortgagees have no lien upon the earnings of the road while it remains in the hands of the receiver, for the trustee does no act equivalent to taking possession of the property till his intervention in the receivership suit.[81]

§ 448. **The president and directors of a railroad company may be continued in possession of the property as receivers; and**

[79] Long Branch &c. R. Co. v. Sneden, 26 N. J. Eq. 539.

[80] Long Branch &c. R. Co. In re, 24 N. J. Eq. 398.

[81] Giles v. Stanton, 86 Tex. 620; 26 S. W. 615.

such is the effect of an order, in suit brought by a state for the foreclosure of a mortgage and the appointment of a receiver, directing these officers to continue in the possession and management of the property under the direction of and subject to the court, and to report to it the condition of the property, its earnings, expenditures, and profits.[82] Such an appointment is very unusual, and the circumstances must be very unusual to justify it.

The fact that a person has been a director and the treasurer of a corporation is no reason why he should not be appointed receiver of it, or why he should be removed from such position.[83]

§ 449. When property is in the hands of trustees who hold their office ex officio as high public officers of the state, and especially where one part of the trust involves duties of a public character, the court will be very reluctant to take the fund out of their hands, and place it in the hands of a receiver, and will not do so except for the most cogent reasons, such as gross fraud and imminent danger of the trust fund.[84] The legislature of Florida vested certain public lands, including all swamp and overflowed lands belonging to the state, in the governor, comptroller, treasurer, attorney general, and register, as trustees, to constitute an internal improvement fund, and to serve, amongst other things, as a guaranty of bonds to be issued by certain designated railroad companies, of which the Florida Railroad Company was one, for the procurement of iron rails and rolling stock. A certificate of guaranty was to be placed on the bonds. In case the interest on these bonds, and one per cent. per annum for a sinking fund, were not paid by any of the companies, the trustees were authorized to take possession of and sell the road, appurtenances, and franchises of the company in default, and to apply the proceeds in purchasing up the bonds, or incorporating them with the sinking fund. The powers given to the trustees were large and various. They were authorized to fix the prices of the lands, to make arrangements for draining them, and to promote

[82] Fifty-four First Mortgage Bonds, In re, 15 S. C. 304; Brown, Ex parte, 15 S. C. 518; Williams, Ex parte, 17 S. C. 396.

[83] Townsend v. Oneonta &c. R. Co. 86 App. Div. (N. Y.) 604; 83 N. Y. S. 1034.

[84] Vose v. Reed, 1 Woods (U. S.), 647.

their settlement and cultivation by allowing preemptions and other modes of encouragement. The Florida Railroad Company having issued a large number of bonds, which were duly indorsed by the trustees, failed to pay any instalments of interest or of the sinking fund, the trustees seized and sold the road, and with the proceeds of the sale purchased and cancelled a large proportion of the outstanding guaranteed bonds of the company. A holder of bonds of the company not so purchased filed a bill in the Circuit Court of United States for the Northern District of Florida, for relief against the trustees, whom he charged with mismanaging the funds, and against other parties and corporations, whom he charged with complicity in such mismanagement by obtaining fraudulent purchasers of the lands at nominal prices. He also prayed for an injunction and the appointment of a receiver of the trust fund. An injunction was granted, awaiting a hearing of the case upon its merits. Upon the question of appointing a receiver, Mr. Justice Bradley, delivering the opinion of the court, after speaking of the objects of the trust as being the development of the resources of the state, the reclamation of the lands, as well as promoting railroad improvements, said:[85] "Now these public and political objects of the trust make it extremely fitting that the chief executive officers of the state should administer the fund. And it must be a very strong case indeed which will induce the court to take the property out of their hands and put it into the hands of its own officers. The legislature has seen fit to intrust the chief officers of the state with these important duties, and it would show a great disrespect to this coordinate branch of the government for the judiciary, on light grounds, to displace these officers from the trust, and to put appointees of its own in their stead." The court will in such case resort to every other coercive means of compelling the trustees to perform their duty before resorting to the extreme measure of a receivership.

§ 450. **Whether the Supreme Court of the United States would in any case appoint a receiver** pending an appeal in that court is an undecided point; but upon motion for a receiver of the Pacific Railroad in Missouri, the court declined to make the appointment

[85] Vose v. Reed, 1 Woods (U. S.), 647, 651.

upon the showing made in that case.[86] Appeals in equity are heard upon the pleadings and proofs below. No new evidence can be admitted, and the pleadings cannot be amended. A decree of foreclosure and sale had been entered in the Circuit Court by consent of the company. The solicitor of the company bought the property at the sale, paying the purchase principally in bonds of the company, secured by the foreclosed mortgage. The owners of the bonds thus paid over organized themselves into a new company, and the property was assigned to them. The receiver who had been appointed in the Circuit Court pending the proceedings was discharged, and was directed to turn over all the property in his hands to the new corporation. Soon after this new company made a new mortgage for a greater sum than that which had been cancelled by foreclosure, and delivered the bonds principally to the parties who had been holders of the bonds surrendered in payment of the purchase money. The stockholders of the old company, at a meeting soon after this, repudiated the action of their directors in allowing a foreclosure decree to be taken; and an appeal was accordingly taken from the decree of foreclosure. The Supreme Court refused to grant the relief asked, because the pleadings did not disclose the defense sought to be made. Although the sale was in form to the company's solicitor, it was in reality to the bondholders for whom the foreclosure was had; and it appeared affirmatively that the original decree was by consent, and no irregularity in the sale was complained of in the court below.

§ 451. The appointment of a receiver in such case may, perhaps, be more appropriately made by the Circuit Court from which the litigation was taken to the Supreme Court. It might be inconvenient, if not impracticable, for the Supreme Court to pass such interlocutory orders as would be necessary to protect the property in litigation. The Circuit Court could, however, act with a full knowledge of the facts, and of the practice in such cases. That court, moreover, has the ultimate disposition of the property under the direction of the Supreme Court. Such a course was pursued by the Circuit Court sitting in Georgia in a suit by Henry Clews

[86] Pacific R. Co. v. Ketchum, 95 U. S. 1; Pacific R. Co. v. Missouri R. Co. 15 Am. Railw. R. 80.

against The Cherokee Railroad Company. While the case was pending before the Supreme Court of the United States, occasion arose for the appointment of a receiver to prevent the waste and destruction of the property. The appointment was made by the Circuit Court. The Supreme Court of Georgia, upon a question whether a receiver appointed in a court of that state should be sustained as against the receiver appointed by the Circuit Court, was of opinion that the latter court had properly made the appointment.[87]

§ 451a. **Right of appeal from interlocutory order.**—The mere appointment of a receiver carries with it the duty on his part of taking possession, and the further duty of those in possession of yielding such possession. Consequently incorporating into such order a direction to defendant to turn over and deliver to the receiver the property in his hands does not constitute it a mandatory injunction, and give a right to appeal from the Circuit Court to the Circuit Court of Appeals. As a part of an order appointing a receiver there is something in the nature of a mandatory injunction, that is a command to the receiver to take and to the defendant to surrender possession, yet such command is not technically and strictly an order of injunction. Orders granting injunctions and orders appointing receivers are, in the common understanding of the profession, entirely independent. We have separate treatises on injunctions and on receivers. Congress, if it had intended that appeals should be allowed from orders appointing receivers, as from orders in respect to injunctions, would doubtless have expressly named such orders. Its omission of the one and mention of the other is a clear declaration that only one should be the subject of appeal and the other not.[88]

§ 452. **The general rule to be deduced** from the many cases showing what facts and circumstances justify the appointment of a receiver in behalf of a mortgagee is, that the appointment will be made when the security is inadequate, or there has been waste or misapplication of the property by the mortgagor or other party in possession; and also when there is danger of such abuse on the mortgagor's part, and of consequent loss to the mortgagee.[89] In-

[87] May v. Printup, 59 Ga. 128; 5 Reporter, 392.

[88] Highland &c. R. Co. v. Columbian Eq. Co. 168 U. S. 627; 18 Sup. Ct. 240.

[89] Keep v. Michigan R. Co. 6 Chicago Legal News, 101.

adequacy of security is always an essential ingredient of a case that calls for such interference, unless it be shown that there is imminent danger of the sacrifice or loss of an adequate security.

There is a well-defined distinction as to the right to have a receiver appointed between a mortgage which pledges the tolls and income of the property, and one which does not. When there is such a pledge of the rents and profits, upon a default and petition of the great body of the bondholders, or of trustees representing them, a receiver is appointed very much as of course.[90] It has been suggested that in such case, instead of the court's assuming the management of the road, it may sometimes be expedient to require the earnings of the road to be paid over to a receiver, to be held and distributed by him,—the interference of others with the management of the road being prevented meanwhile by injunction.[91]

§ 453. As a general rule, a receiver appointed in a prior suit should not be displaced by the appointment in a subsequent suit of a receiver of the same subject-matter by the same court. The receiver does not represent the plaintiff in the suit, but the court. Unless there be special occasion for displacing the receiver first appointed, the proper course of practice is to extend the receivership in the first suit over the second, subject to the legal and equitable claims of all parties, and the rights of the parties in each suit are substantially the same as if different persons had been appointed at the several times when such receivership was granted. If, however, a different receiver be appointed in the second suit, the receiver in the first suit is displaced, and must deliver the property to the receiver appointed in the second.[92]

The appointment of a receiver, on the application of junior mortgagees, may be extended to cover an application for a receivership by the prior mortgage creditors.[93]

Where an entire railroad system, composed of many separate roads, is in the hands of receivers appointed to preserve the entire road as a going concern, an application by the trustees of an under-

[90] Des Moines Gas Co. v. West, 44 Iowa, 23, 25.

[91] Per Manning, J., in Meyer v. Johnston, 53 Ala. 237, 350.

[92] State v. Jacksonville &c. R. Co. 15 Fla. 201, 276.

[93] Taylor v. Philadelphia &c. R. Co. 14 Phila. (Pa.) 457.

lying mortgage of one of the original roads, to have the property covered by their mortgage turned over to receivers appointed in a suit to foreclose their mortgage, was denied for the time being, in view of negotiations for the sale of the entire system under the general mortgage.[94]

In foreclosing a mortgage against a corporation in the hands of a receiver, the mortgagee properly asserts his right to possession by obtaining leave to intervene in the receivership suit, and such intervention gives a prior right to income earned by the receiver thereafter as against ordinary judgment creditors intervening subsequently. It is not essential that a new receiver be appointed or the existing receivership be formally extended to the mortgagee's suit.[95]

§ 454. As a general rule, a receiver should not be appointed without notice to the mortgagor or other party in possession and an opportunity to be heard. It would be a case of great urgency, and where delay would involve a serious injury to the property in controversy, or irreparable injury to the applicant, that would justify an appointment before service of process, or the appearance of the defendant, and notice of the motion.[96] During the interval between the application for the appointment of a receiver and the hearing after notice, sufficient protection of the plaintiff's rights can usually be afforded by an injunction or other restraining order.[97]

Upon an application for a receiver, the mortgagee is not required to establish conclusively his right to recover, but merely to show a probable right, especially when he is entitled by the terms of the mortgage to the income, rents, and profits of the mortgaged property.[98]

[94] Central Trust Co. v. Wabash &c. R. Co. 25 Fed. 693.

[95] Atlantic Trust Co. v. Dana, 128 Fed. 209.

[96] Pressley v. Harrison, 102 Ind. 14; 1 N. E. 188; Whitehead v. Wooten, 43 Miss. 523; Brinkman v. Ritzruger, 82 Ind. 358.

[97] Florida v. Jacksonville &c. R. Co. 15 Fla. 201; and see Cincinnati &c. R. Co. v. Sloan, 31 Ohio St. 1; 15 Am. Railw. R. 376; Railway Co. v. Jewett, 37 Ohio St. 649; High Receivers, §§ **111, 112.** In Louisiana the appointment of a receiver of a corporation on an ex parte application, without alleging its insolvency, is held to be absolutely null. Turgeau v. Brady, 24 La. Ann. 348.

[98] Des Moines Gas Co. v. West, 44 Iowa, 23.

Where the propriety of the appointment of a receiver is the principal question before the court, and it is required, if at all, by the view which the court shall ultimately take of the case, and not for a merely ancillary purpose connected with the temporary incidents of the suit, action as to the appointment will be deferred till the hearing.[99]

Where a receiver has been appointed by a state court upon an *ex parte* application, and, after the removal of the suit to the Circuit Court, it appears upon a hearing that there is no occasion for a receivership, and that its continuance is likely to prove prejudicial to innocent holders of the company's securities, the order appointing the receiver should be rescinded.[100]

An appointment in vacation, unauthorized by law, is of no effect,[101] but if the appointment be afterwards confirmed by the court in term, it will be deemed to have been made by the court from and after the entry of the confirming order.[102]

After an application for the appointment of a receiver has been allowed to sleep for six years, it will be denied, although some testimony has been taken in the mean time.[103]

A court will not appoint a receiver of a corporation on a preliminary application by a bondholder, where all charges of fraud and mismanagement and all allegations which would authorize the appointment are denied, but will postpone action till a hearing on the evidence.[104]

§ 455. When an individual bondholder or a judgment creditor seeks the appointment of a receiver, he must sue on behalf of himself and all other persons who have interests of the same kind or class as his own. In such a proceeding he acts as trustee for all others who are entitled to be paid *pari passu* with him.[105] It is not

[99] Union &c. Ins. Co. v. Union Mills &c. Co. 37 Fed. 286.

[100] McHenry v. New York &c. R. Co. 25 Fed. 114.

[101] Hammock v. Farmers' &c. Co. 105 U. S. 77; 13 Fed. 189n; Blair v. Reading, 99 Ill. 600; Devine v. People, 100 Ill. 290.

[102] Hervey v. Illinois &c. R. Co. 28 Fed. 169.

[103] Hood v. First Nat. Bank, 29 Fed. 55.

[104] Brady v. Bay State Gas Co. 106 Fed. 584.

[105] Bowen v. Brecon R. Co. L. R. 3 Eq. 541; Potts v. Warwick &c.

necessary that the other parties in interest should concur in the application.[106]

§ 456. **If the mortgaged premises are in the possession of a tenant or lessee,** it is necessary to make him a party to the suit before a receiver of the property can be appointed. If he be not made a party, there is no objection to the appointment of a receiver of the rents and profits to whom the tenant could be required to attorn; but such receiver would have no power to molest the possession of the tenant.[107]

§ 457. **The fact that a corporation is insolvent will not authorize the corporation itself to apply** to a court of equity for a receiver to wind up its affairs. A creditor in a proper case may come into court with such application, but the insolvent debtor cannot.[108] A corporation cannot apply in its corporate capacity and name to be put into the custody of a receiver.[109]

II. *Selection of Receivers.*

§ 458. **In the appointment the court is not necessarily controlled by the express wish of the parties,** although the mortgagee and mortgagor both concur in asking for the appointment of the same person. If such person be one under whose charge the resources of the road have been exhausted and the necessity for a receiver brought about, the court will probably refuse to make the appointment. The receiver is not the servant of the bondholders, but of the court, which must impartially regard the interests of other creditors of the insolvent corporation.[110] The court should, at any rate, be satisfied of the fidelity and ability of the person to whom

Co. Kay, 142; Fripp v. Chard R. Co. 11 Hare, 241; Gravenstine's Appeal, 49 Pa. St. 310.

[106] Fripp v. Chard R. Co. 11 Hare, 241.

[107] Keep v. Michigan &c. R. Co. 6 Chic. L. N. 101; Sea Ins. Co. v. Stebbins, 8 Paige (N. Y.), 565.

[108] Hugh v. McRae, Chase's Dec. (U. S.) 466.

[109] Kimball v. Goodburn, 32 Mich. 10.

[110] Richards v. Chesapeake &c. R. Co. 1 Hughes (U. S.), 28; Atkins v. Wabash &c. R. Co. 29 Fed. 161.

the property is intrusted during the pendency of the suit; and although it may be proper that officers of the corporation, to whom no fault is imputed, should be continued in the management of it as receivers,[111] when there has been mismanagement the control of the road should not be given to those whose administration of its affairs had ended in bankruptcy.[112] It has been declared, moreover, that an officer of a corporation under whose management it has become insolvent is not a proper person to be appointed a receiver. A person who cannot, with the aid of others, manage a business successfully, is, as a general rule, regarded as unfit to wind it up alone.[113] Generally, also, one who is interested in the corporation as a stockholder or an officer should not be appointed a receiver unless the occasion is exceptional and urgent, and then only on the consent of parties whose interests are to be intrusted to their charge.[114]

Where a receiver has been put in possession of a road, under an agreement between the parties in interest in a foreclosure suit that the complainants, upon giving security in the sum of $350,000, should have possession of the road and should name the receiver, the other parties are placed in a somewhat different attitude towards that officer from what they would be in if he were appointed by the court in the ordinary way; for it does not lie with them to object to the *person* of the receiver, though he be a complainant in the suit, unless he commits some overt act of unfaithfulness to his trust, which can be specified and proved. They cannot go into his previous transactions in the suit, in order to show that he had heretofore done acts which exposed him to personal animadversion.[115]

Where a court has the parties and subject-matter before it, and jurisdiction to appoint a receiver, the mere fact that it appoints an improper person will not render the judgment void.[116]

§ 459. It is not unusual for parties representing different in-

[111] Meyer v. Johnston, 53 Ala. 237.

[112] Williamson v. New Albany R. Co. 1 Biss. (U. S.) 198.

[113] McCullough v. Merchants' &c. Co. 29 N. J. Eq. 217; Freeholders v. State Bank, 28 N. J. Eq. 166.

[114] Atkins v. Wabash &c. R. Co. 29 Fed. 161.

[115] Cowdrey v. Railroad Co. 1 Woods (U. S.), 331.

[116] San Antonio &c. R. Co. v. Adams, 11 Tex. Civ. App. 198; 32 S. W. 733.

terests to agree upon the appointment of two or more receivers, each of whom is expected to represent and look after the interests of one of the parties; and the courts have usually appointed the receivers so agreed upon. So long as harmony prevails between receivers so appointed, there may be no difficulty experienced in operating the road under such management, excepting the additional expense of two or more receivers where only one is required. But it must be observed that this practice is of doubtful utility. Dissensions are apt to arise between the representatives of discordant or hostile interests, and then the practicable management of the road by them becomes impossible. In a case where this had been the result of appointing such receivers,[117] Mr. Justice Miller, in removing them to make way for one receiver who should represent the court and be strictly neutral in both feeling and conduct, said: "I have only one word to add: In my view a receiver is strictly and solely the officer of the court, if, by reason of the inability or neglect of the officers of the corporation to conduct its business as it ought to be done, the conduct of that business is taken charge of by the court, and carried on by its agent. It is the duty of that agent to so conduct this business as that the lawful rights and legal interest of all persons in the property and in the business shall be protected as far as possible with equal and exact justice. This is much more likely to be done by a receiver who has no interest in the capital stock of the road; none in its debts, and no obligations to those who have; such a person, acting under the control of the court, seeking its advice, as he would be inclined to do, in all questions of doubtful duty, and bound in sufficient surety for the faithful performance of his duty, is, in my opinion, the proper one for such an office."

Generally it may be said that the existence of two receivers representing opposing interests is unnecessary and embarrassing, even if they are on amicable terms, and have but a single place of business. But their different interests are almost certain to render them antagonistic, and in that event a successful operation of the road is rendered impossible. As remarked by Mr. Justice Miller in the case under consideration, while it may be true that a large personal interest may stimulate the activity and direct the vigilance, whenever

[117] Meier v. Kansas City R. 11 Chic. L. N. 41, 5 Dill. (U. S.) 476, 479; 4 Dill. (U. S.) 378.

occasion offers that vigilance will be directed mostly to advancing personal interests, and that activity to securing personal advantages.

§ 460. The appointment of a receiver once made cannot be assailed in a collateral proceeding where it appears that the court has jurisdiction of both the subject-matter and of the necessary parties. However erroneous the order of appointment may have been, it cannot be treated as void, but at the most only as voidable in a direct proceeding for that purpose.[118] The same observations apply equally to an order granting an injunction against the prosecution of a suit or judgment against a receiver.[119]

Where the fact of the appointment of a receiver is put in issue by the pleadings, a copy duly authenticated of the order appointing him is admissible evidence of the appointment.[120]

III. *Jurisdiction of Receivers.*

§ 461. A receiver's authority is limited to the jurisdiction of the court appointing him. The authority of a receiver cannot ordinarily extend beyond the limits of the territory within which the court making the appointment has jurisdiction, whether this be a state, county, or other local district. If the court making the appointment has jurisdiction throughout a state, the receiver has authority to take possession of property embraced in the receivership anywhere in the state, but he has no authority beyond that state, except so far as he is allowed to act in other states through the comity of other governments. A receiver appointed by a court having jurisdiction of a limited judicial district within a state has no authority to take possession of property in another judicial district.[121] The inability of a receiver to exercise any extra-territorial power has been asserted by some courts with great positiveness;[122] and sometimes courts seem to have unqualifiedly refused to recognize a for-

[118] Richards v. People, 81 Ill. 551.

[119] Richards v. People, 81 Ill. 551.

[120] Allen v. Central R. Co. 42 Iowa, 683.

[121] Florida v. Jacksonville &c. R. Co. 15 Fla. 201.

[122] Booth v. Clark, 17 How. (U. S.) 322; Fowler v. Osgood, 141 Fed. 20; Hilliker v. Hale, 117 Fed. 220.

eign receiver, and allow him to maintain actions, on any ground whatever.[123] On the other hand, the fullest authority has been accorded to foreign receivers to bring suits with reference to the property they were appointed to take charge of.[124] When the title of the receiver is not merely one derived from his appointment as such by a foreign court, but he has himself acquired a title personal to himself by reducing the property to possession,[125] or by an assignment of the property from the debtor,[126] his right to pursue the property in a foreign jurisdiction may be regarded as certain. He has in such a case a right of action in his individual capacity.

§ 462. The generally recognized doctrine, however, is that a receiver appointed in one state has no power to institute proceedings in the courts of another state, except by comity and interstate and international courtesy; but upon this principle a receiver is generally allowed to sue in foreign courts, unless the claim he is seeking to enforce comes in conflict with creditors in that state, claiming under attachment or other lien.[127] As against a foreign corporation and a receiver appointed in another state, courts sometimes protect creditors in their own states by sustaining attachments of property actually within the state where suit is brought; and if in such case a receiver be subsequently appointed in that state, he takes the property subject to any lien that may have been acquired by the attaching creditor.[128]

[123] Farmers' &c. Co. v. Needles, 52 Mo. 17.

[124] Paradise v. Farmers' &c. Bank, 5 La. Ann. 710; McAlpin v. Jones, 10 La. Ann. 552.

[125] Cagill v. Wooldridge (Tenn.), 4 Cent. L. J. 6.

[126] Graydon v. Church, 7 Mich. 36, 51.

[127] Hoyt v. Thompson, 5 N. Y. 320; Willitts v. Waite, 25 N. Y. 577; Graydon v. Church, 7 Mich. 36; Taylor v. Columbian Ins. Co. 14 Allen (Mass.), 353; Hunt v. Columbian Ins. Co. 55 Me. 290, 298; 92 Am. Dec. 592; Cagill v. Woold. (Tenn.) 4 C. L. J. 6; Bank v. McLeod, 38 Ohio St. 174, 183; Hurd v. Elizabeth, 41 N. J. L. 1; Norwood, Ex parte, 3 Biss. (U. S.) 504; Patterson v. Lynde, 112 Ill. 196; Bagby v. Atlanta &c. R. Co. 86 Pa. St. 291; Sercomb v. Catlin (Ill.), 5 Railw. & Corp. L. J. 610.

[128] Dunlop v. Paterson Fire Ins. Co. 12 Hun (N. Y.), 627; Taylor v. Columbian Ins. Co. 14 Allen (Mass.), 353. See Osgood v. Maguire, 61 N. Y. 524, respecting the situs of property in the form of promissory notes in the hands of a receiver. The case is in conflict

Pending an application for the appointment of a receiver in a Kentucky court for the enforcement of a mortgage, certain rolling stock covered by the mortgage and temporarily in the State of Ohio was there attached by an unsecured Kentucky creditor. The receiver was allowed to assert his right to the possession of the attached property by a suit brought in Ohio. The mortgage being valid in Kentucky was valid in Ohio; and the receiver's right of possession, not being in conflict with any rights of a citizen of Ohio, nor against the policy of its laws, the Ohio court, regarding the comity existing between states, allowed the Kentucky receiver to maintain the action.[129]

A foreign receiver may sue for the collection of unpaid stock subscriptions, when resident creditors have no liens thereon.[130]

A receiver appointed by a state court for a corporation of the state may sue in the Circuit Court of the United States for another state on a judgment obtained in the state court upon a promissory note, as in such case he sues, not as a receiver, but as a judgment creditor.[131]

462a. The burden is upon a receiver appointed by the courts of one state to show he has power and authority to maintain an action in the courts of another state.[132] A receiver derives his authority from the act of the court appointing him, and not from the act of the parties at whose suggestion or by whose consent he is appointed, and the utmost effect of his appointment is to put the property from that time into his custody as an officer of the court for the benefit of the party ultimately proved to be entitled, but not to change the title, or even the right of possession of the property.[133]

with the Massachusetts case on this point.

[129] Bank v. McLeod, 38 Ohio St. 174, 183. "We think that, upon both principle and authority, such an action may be maintained. The nature of the union between the states, as members of a common government, the vital interests which bind them together, should lead us to presume a greater decree of comity, in commercial as well as in political affairs, than we should be authorized to presume between states wholly foreign to each other." Per Johnson, J.

[130] Patterson v. Lynde, 112 Ill. 196.

[131] Wilkinson v. Culver, 25 Fed. 639.

[132] Great Western &c. Co. v. Harris, 128 Fed. 321; 63 C. C. A. 51; Hilliker v. Hale, 117 Fed. 220; 54 C C. A. 252.

[133] Union Bank v. Kansas Bank,

§ 463. It is a rule of law in all cases of conflict of jurisdiction, that the court which first takes cognizance of the controversy is entitled to retain jurisdiction to the end of the litigation, and incidentally to take possession of the subject-matter of the dispute through a receiver, to the exclusion of all interference from other courts of coordinate jurisdiction. As remarked by Judge Blodgett, in a case before the Circuit Court of the United States for Northern Illinois,[134] "The proper application of this rule does not require that the court which first takes jurisdiction of the case shall also first take, by its officers, possession of the thing in controversy, if tangible and susceptible of seizure, for such a rule would only lead to unseemly haste on the part of officers to get the manual possession of the property; and while the court first appealed to was investigating the rights of the respective parties, another court, acting with more haste, might, by a seizure of the property, make the first suit wholly unavailing. To avoid such a result, the broad rule is laid down that the court first invoked will not be interfered with by another court while the jurisdiction is retained." Thus, if after the filing of a bill against a railroad company in the Circuit Court of the United States in which the appointment of a receiver is asked for, and before such appointment is made, a suit be commenced in a state court for the appointment of a receiver of the same property, the state court, although it may take possession of the property through its receiver, cannot supersede the jurisdiction of the Circuit Court; but the latter court will proceed in due course to appoint a receiver, if occasion for such action be shown, and will assert its jurisdiction. The adding of a new party and raising a new question as to him is not enough to give jurisdiction to another court.[135]

A state court may appoint a receiver for a subsidiary line, although a federal receiver is in possession of the entire system, and upon a proper showing in the federal court by the state receiver the sub-

136 U. S. 223, 236; 10 Sup. Ct. 1013; 34 L. Ed. 341; Edwards v. Nat. Window G. J. Ass'n, 139 Fed. 795.

[134] Union Trust Co. v. Rockford &c. R. Co. 6 Biss. (U. S.) 197, 198; Alabama &c. R. Co. v. Jones (U. S.), 7 N. B. R. 145; Bill v. New Albany R. Co. 2 Biss. (U. S.) 390; Keep v. Mich. R. Co. 6 Chic. L. N. 101; Sedgwick v. Menck, 6 Blatchf. (U. S.) 156.

[135] Memphis v. Dean, 8 Wall. (U. S.) 64.

sidiary line will be turned over to him.[136] But it is not sufficient cause merely to show that the corporate charter of the subsidiary road has been declared forfeited by the state courts, and the transfer to the operating company was *ultra vires*.[137]

§ 464. **Where the conflict of jurisdiction does not relate to the cause, but to the possession of the subject-matter,** priority of possession may be the test of the right to retain possession.[138] The question whether an actual seizure of the property is necessary to the jurisdiction of the court in a case where the possession of the property is necessary to the relief sought, or whether the commencement of the action and service of process, or the commencement of the action by the filing of the bill, is sufficient to give the court jurisdiction, to the exclusion of all other courts, was discussed in a recent case.[139] The bill in that case was filed the thirtieth day of October, 1874, for a foreclosure of a mortgage, and a copy and notice of motion for injunction and receiver were served on the railroad company the next day. On the ninth of November following, the company was enjoined from yielding possession of the property to any one except a receiver appointed by the court in this case. A creditor of the company having recovered judgment, levied his execution upon the road, and sold it in different parcels, and the purchaser was put in possession by the sheriff on the same ninth day of November. On the next day the company, by its managing director, filed a bill in the Superior Court of Fulton County, in the State of Georgia, to prevent the judgment creditor and the purchaser from taking possession of the road. On November twentieth the purchaser filed a cross-bill in the same court, asking for the appointment of a receiver; and a receiver was the next day appointed, who, on the twenty-sixth of the same month, took possession. The Circuit Court, on the nineteenth of December following, appointed a re-

[136] Central R. &c. Co. v. Farmers' &c. Co. 56 Fed. 357.

[137] Mercantile Trust Co. v. Missouri &c. R. Co. 48 Fed. 351.

[138] Mallett v. Dexter, 1 Curtis (U. S.), 178; Wiswall v. Sampson, 14 How. (U. S.) 52; Chittenden v. Brewster, 2 Wall. (U. S.) 191; Buck v. Colbath, 3 Wall. (U. S.) 334; Memphis v. Dean, 8 Wall. (U. S.) 64; Watson v. Jones, 13 Wall. (U. S.) 679; Bill v. New Albany R. Co. 2 Biss. (U. S.) 390; Parsons v. Lyman, 5 Blatchf. (U. S.) 170.

[139] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409.

ceiver of the entire property covered by the mortgage, but the receiver was unable to get possession of that part of the trust property lying in Georgia, and on the twenty-fourth of May, 1875, he applied to the court for a writ of assistance to enable him to get possession of the property in Georgia. Judge Woods, in appointing the receiver of the Circuit Court, was of opinion that the filing of the bill in that court and the service of process excluded the jurisdiction of all other courts to take possession of and administer the property or any part of it. But Mr. Justice Bradley, before whom the application for the writ of assistance was heard, differed from Judge Woods as to the jurisdiction and powers of the court, saying: "It is too well settled to admit of controversy, that where two courts have concurrent jurisdiction of a subject of controversy, the court which first assumes jurisdiction has it exclusive of the other. But where the objects of the suits are different this rule does not apply, although the thing about or in reference to which the litigation is had is the same in both cases. Thus, an action of debt on a bond, an action of ejectment on the mortgage given to secure it, and a bill in equity to foreclose the equity of redemption, may be pending at the same time, unless prohibited by some statutory regulation. The land mortgaged may be seized in execution by the sheriff in an action at law, even while the ejectment or the bill to foreclose is pending. A bill to foreclose is a personal proceeding, although it has reference to a specific thing. Its object is to put an end to an existing equity, and to procure a sale of the mortgaged premises. Possession may be taken in the course of the proceeding, but until it is taken, can it be said that the property is sacred from the touch of other persons or courts? . . .

"The test, I think, is this: Not which action was first commenced, nor which cause of action has priority or superiority, but which court first acquired jurisdiction over the property. If the Fulton County Court had the power to take possession when it did so, and did not invade the possession or jurisdiction of this court, its possession will not be interfered with by this court; the parties must either go to that court and pray for the removal of its hand, or, having procured an adjudication of their rights in this court, must wait until the action of that court has been brought to a close, and judicial possession has ceased. Service of process gives jurisdiction

over the person. Seizure gives jurisdiction over the property; and until it is seized, no matter when the suit was commenced, the court does not have jurisdiction. The alleged collusion and fraud of the parties cannot alter the case. It is a question between the two courts; and we must respect the possession and jurisdiction of the sister court. We cannot take the property out of its hands unless it has first wrongfully taken it out of our hands. This, as we have shown, has not been done. The application for a writ of assistance and for an attachment must be denied."[140]

§ 465. **The mere filing of the bill may give jurisdiction of the thing in controversy,** in a case where the only recovery can be out of the property, so as to prevent another court from appointing a receiver.[141] The decision of the case cited, however, was made in view of facts showing a case of collusion in the appointment of a receiver in a court of the state. In a suit against the Cherokee Railroad Company, begun in the Circuit Court in 1872, a receiver was appointed, but afterwards, by consent, this appointment was revoked; but the case otherwise remained the same, and after a decree in favor of the plaintiff, the case was carried to the Supreme Court of the United States. While it was there pending, in September, 1876, certain parties, some of whom were parties defendant in the former suit, filed a bill in a court of the state, praying, among other things, for the appointment of a receiver. On October second the chancellor passed an order for a hearing on the twenty-third day of the same month, and for perfecting service ten days before that time. Afterwards, by consent, the hearing was set for the tenth day of the month, when a receiver was appointed. Meanwhile, pending the former case in the Supreme Court, the appointment of a receiver was applied for in the Circuit Court, and a hearing was had and a receiver was appointed on the twentieth of October. This receiver found the receiver appointed by the state court in possession; whereupon, under the direction of the Circuit Court, he applied to the

[140] Quaere as to correctness of this opinion.

[141] May v. Printup, 59 Ga. 128; 5 Reporter, 392. The court refer to the opinion of Mr. Justice Bradley, 2 Woods (U. S.), 409, 425, 427, stated in the preceding section, to the contrary, and dissent from it on this point.

state court for the possession of the property. The chancellor granted an order to that effect, which was affirmed by the Supreme Court of the state, upon the ground that the chancellor made the appointment inadvertently, and without knowledge of the facts of the proceedings in the federal court, and under circumstances indicating a collusion of parties in obtaining the appointment.

§ 466. **When a receiver has once obtained actual possession of the property committed to his charge, he cannot be interfered** with by a receiver subsequently appointed in another court.[142] When a question is pending in one court of competent jurisdiction, it cannot be raised and agitated in another court; much less can a court assume to take possession of and administer property which is in possession of another court, and in course of administration by it.[143] Upon the institution of proceedings in bankruptcy in a United States court under the Bankruptcy Act of 1867, against an insolvent railroad company, already in the hands of a receiver appointed under proceedings in a state court, his possession will not be interfered with except for some cause for which his title might be impeached under the Bankrupt Act.[144] A court of the United States will not entertain a bill for an account against the receiver of a corporation appointed by a state court, but will leave the petitioner to pursue his remedy in the court from which the receiver derived his appointment.[145] Neither will the court appoint a receiver of property which is in the possession of a person not a party to the suit. Such person may be made a party, and the objection is then removed.[146]

§ 467. **When, however, a line of railway extending through several states belongs to the same corporate body** which the several states, by concurrent legislation, have united in creating, a court having jurisdiction of the corporation has jurisdiction of its prop-

[142] O'Mahoney v. Belmont, 5 J. & S. (N. Y.) 380; Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409; Fort Wayne &c. R. Co. v. Mellett, 92 Ind. 535.

[143] Young v. Montgomery &c. R. Co. 2 Woods (U. S.), 606.

[144] Alden v. Boston &c. R. Co. 5 N. B. R. 230.

[145] Conkling v. Butler, 4 Biss. (U. S.) 22.

[146] Searles v. Jacksonville &c. R. Co. 2 Woods (U. S.), 621; Florida v. Jacksonville &c. R. Co. 15 Fla. 201, 280.

erty, both within the state and beyond its limits, and may appoint a receiver of the whole. The Atlanta and Richmond Air Line Railway Company, extending from Atlanta, in Georgia, through South Carolina to Charlotte, in North Carolina, having mortgaged its entire road and property, and made default in the payment of interest, executions were issued against the company, and a receiver was appointed in each of the three states, although the same person was appointed in the States of North and South Carolina. There were, therefore, three distinct and independent courts claiming possession of different portions of the road and other property of the company, and it was in the actual possession of two different receivers, living in different states and accountable to different tribunals. In this position of the affairs of the company the bondholders secured by the mortgage applied to the Circuit Court of the United States to appoint a receiver for the entire line of the road.[147] The bill averred that this railroad property was one inseparable and indivisible piece of property; that it was a portion of a great through route, and derived its chief value and business from that fact. "It is obvious," said the Circuit Court Judge, Mr. Woods, in appointing the receiver, "that it would be a most unfortunate case that such a property should be held by two different receivers, accountable to three different courts. In fact, when we consider that a large part of the property of the company consists of rolling stock, which must necessarily pass from one end of the road to the other, and which must be used on the three divisions into which the road is divided by its administration in three different courts, it appears to be well-nigh impossible to administer the affairs of the road and render accurate and satisfactory accounts. It is evident that such a divided control must result in crippling the operations of the road, destroying its business and reducing its receipts, and placing in jeopardy the security of its creditors. This unfortunate condition of affairs, resulting from the action of three independent courts, would of itself be, as it appears to us, sufficient ground for the appointment of a receiver for the entire property by this court, if the power and jurisdiction of this court to do so is clear."

The property of the company in such case is one entire and indivisible thing. If the receiver is compelled to ask the assistance

[147] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409, 416.

of courts of other jurisdictions to aid him in obtaining possession of the property, those courts would feel constrained, as a matter of comity, to afford all necessary aid to put him in possession.[148] If the suits are commenced in courts of coordinate jurisdiction, and receivers are appointed by both, it would seem that the court which first seizes the property acquires jurisdiction over it, to the exclusion of the other, without reference to the time when the suits were commenced.[149]

Where a Circuit Court of the United States has appointed receivers for a railroad which lies only partly within its district, another court, within whose district a portion of the road lies, will on application appoint the same receivers, the portions of the road not being capable of separate management without injury.[150]

§ 468. Two or more states may, by concurrent legislation, unite in creating the same corporate body, so that, instead of two or more separate bodies in the different states, there is one consolidated body having the same rights and functions in the one state that it has in the other.[151] A court having jurisdiction over a corporate body of this kind, such, for instance, as a consolidated line of railroad, may exercise jurisdiction over its real and personal property outside of the limits of the state to which the jurisdiction of the court is ordinarily limited, by the appointment of a receiver to take possession of the entire property, both within and without the state. The court having jurisdiction of the corporation may, through that, reach its property situated outside the territorial jurisdiction of the court. If necessary, it might require assignments to be made by the company to the receiver.[152] If other persons outside the territorial jurisdiction of the court have seized the property of the company, so that the court cannot reach it by controlling the company, the receiver may be compelled to ask the assistance of the courts of that

[148] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409, 416; and see Ellis v. Boston &c. R. Co. 107 Mass. 1.

[149] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409, 416.

[150] Dillon v. Oregon &c. R. Co. 66 Fed. 622.

[151] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409; and see Ellis v. Boston &c. R. Co. 107 Mass. 1.

[152] Muller v. Dows, 94 U. S. 444; Northern Ind. R. Co. v. Michigan Cent. R. Co. 15 How. (U. S.) 233, 243.

jurisdiction to aid him in obtaining possession; but the courts of other jurisdictions would feel constrained, as a matter of comity, to afford all necessary aid in their power to put such receiver in possession.[153]

§ 469. Receivers of a railroad appointed by one jurisdiction are not entitled, as of right, to recognition in other jurisdictions into which the line of road extends. A court of equity cannot acquire extra-territorial jurisdiction over property by appointing receivers.[154] Even if, at the time of the appointment of receivers by the Circuit Court of the United States in the original suit, ancillary proceedings are had in another state, and the Circuit Court of the United States in that state enters an order appointing the same receivers for the property in that state, but in the order reserves the power to make such further orders in the premises as may be necessary, the latter court may afterwards remove the receivers so

[153] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.), 409.

[154] Booth v. Clark, 17 How. (U. S.) 322; Atkins v. Wabash &c. R. Co. 29 Fed. 161. In Mercantile T. C. v. Kanawha &c. R. Co. 39 Fed. 337, 340, Mr. Justice Harlan said: "The request that this court will simply confirm the appointment of a receiver made in another circuit, and by its order invest that receiver with the possession and control of the mortgaged premises within this district—no other relief being contemplated,—is, in effect, a request that this court will compel all who have claims and rights in respect to the mortgaged property situated in West Virginia to seek relief in the original suit for foreclosure pending in another state; and this notwithstanding such parties may have the right, under existing legislation, to invoke the jurisdiction of this court, or of some court of general jurisdiction established by this state. It might be well if Congress would so enlarge or regulate the jurisdiction of the courts of the United States as to enable a circuit court in which is brought an original suit for the foreclosure of a mortgage resting upon an interstate railroad to take actual possession, by its officers, of the entire line, and of all the mortgaged property, wherever situated, and administer it for the benefit of all concerned; preserving in that mode the unity of the railroad and the just rights of mortgagors, mortgagees, creditors, and the general public interested in commerce among the states. But there has been no such legislation, and we do not see our way clear to effect any such result by judicial orders merely."

appointed so far as the lines of road in the latter state are concerned.[155]

It seems to be the general practice in federal courts to grant an ancillary receivership in *ex parte* applications.[156]

§ 470. A receiver appointed by a court having jurisdiction of the cause cannot be interfered with by a court of coordinate jurisdiction under proceedings subsequently commenced in a different cause of action.[157] When a junior mortgagee has first brought a suit to foreclose his mortgage, and the court has taken possession of the mortgaged property by a receiver, a senior mortgagee cannot gain possession of the property while that suit is pending by a suit subsequently begun in another court. He can only interfere with such possession by being admitted as a party to the first suit. The senior mortgagee may commence a suit to foreclose his mortgage in another court having jurisdiction; but no matter what he may be able to show as to the incompetency, unfitness, or dishonesty of the receiver appointed in the prior suit by the junior mortgagee in another court, he can neither obtain the removal of that receiver nor the appointment of another except by going into that court and presenting his claims there.

Those who claim the disposition or possession of property in the hands of receivers of a court must come to that court to reach it; and an independent suit for that purpose cannot be maintained even in the same court.[158]

Where a court of common pleas, or other inferior court having jurisdiction, has appointed a receiver who has taken possession of a railroad, the Supreme Court of the state, having concurrent jurisdiction, will not issue a mandamus against such receiver directing his conduct in operating the road.[159]

[155] Atkins v. Wabash &c. R. Co. 29 Fed. 161, 174. Gresham, J., said: "While this court claims no authority to review the action of the court at St. Louis, and regrets that it is forced to meet the questions presented by the record, it cannot concede to that court paramount jurisdiction over the property in Illinois."

[156] Platt v. Philadelphia &c. R. Co. 54 Fed. 369.

[157] Young v. Montgomery &c. R. Co. 2 Woods (U. S.), 606.

[158] American &c. Co. v. Central Vermont R. Co. 86 Fed. 390.

[159] State v Marietta &c. R. Co. 35 Ohio St. 154.

The exclusive jurisdiction of the court which first appointed a receiver terminates with the final decree of that court discharging the receiver, and directing him to surrender the property to the mortgagor.[160]

§ 471. A sale of property under process of one court, while the same is in the possession of a receiver appointed by another is an interference with such possession, and therefore illegal and void,[161] though it is contended that such sale is not an interference with the receiver's possession when the receiver is in possession pending a suit involving the right of possession merely, such as a suit to redeem; though it is admitted that when a court is in possession of property by means of a receiver, at the suit of creditors, for the purpose of disposing of the same, and distributing the proceeds, a sale or an attempt to sell such property on the process of another court is, in effect, an interference with such possession.[162]

The same principle applies in case of an attempted sale by a trustee under a deed of trust of property in the hands of a receiver. Such a sale is void and cannot be sustained, the same reasons applying as in the case of a sale on execution.[163]

§ 472. By the comity existing between the courts of the different states, although a receiver has no extra-territorial jurisdiction, his appointment and title are recognized in other states when his claims do not come in conflict with those of citizens of the state in which adverse proceedings arise.[164] Thus, a receiver having been appointed in Virginia in a foreclosure suit against the Atlantic, Mississippi and Ohio Railroad Company, a citizen of that state soon afterwards attached by trustee process, in a court of the State of Pennsylvania, certain funds and credits of that company in the hands of the Pennsylvania Railroad Company. The receiver claimed the funds, and his

[160] Mobile &c. R. Co. v. Davis, 62 Miss. 271.

[161] Wiswall v. Sampson, 14 How. (U. S.) 52; Ellis v. Water Co. 86 Tex. 109; 23 S. W. 858.

[162] Holladay Case, 29 Fed. 226.

[163] Scott v. Crawford, 16 Tex. Civ. App. 477, 480; 41 S. W. 697.

[164] Metzner v. Bauer, 98 Ind. 425; Patterson v. Lynde, 112 Ill. 196; Bank v. McLeod, 38 Ohio St. 174; Central Trust Co. v. Wabash &c. R. Co. 29 Fed. 618, and in connection with this case, Atkins v. Wabash &c. R. Co. 29 Fed. 161.

right to them was sustained; the court declaring that a creditor had no right, after the appointment of a receiver by a court within his own state, binding upon him there, to attempt to avoid its effect by escaping from its jurisdiction, and going into another state and asking the courts there to infringe the comity due to the acts of the courts of his own state. Instead of comity this would be unfriendliness, for it would be asking the courts of a foreign state to aid in the violation of the law of the plaintiff's own state.[165]

A citizen of the State of Massachusetts, appointed a receiver of an Ohio corporation by the United States Circuit Court in the latter state, may maintain an action in that court for the recovery of assets of such corporation wrongfully withheld.[166] A receiver may generally sue in the courts of another state. His power to do so, however, arises from comity merely, unless there be a special statute authorizing such a suit; and is generally kept subordinate to the rights of local creditors, as respects property within the jurisdiction where such a suit is brought.[167]

§ 473. When property has once vested in a receiver within the jurisdiction of his appointment he can take it into another state, and the law of such other state will not divest him of his right to it. If it be attached in such other state as the property of the corporation of whose property the receiver has been put in charge, the courts will inquire whether he has such right to the property when it comes into the state as between himself and the citizens of the state; but when the fact that he had such right is ascertained, they will not regard it as important by what mode the right was acquired. It makes no difference whether the property vested in the receiver under the local law of another state or under the common law. Neither is it a matter of any importance whether the title to the property in such case passes to the receiver or remains technically with the corporation, so long as the property is taken from the corporation and placed in the hands of the receiver under the direction of the court.[168] If such property be already in the state when the receiver

[165] Bagby v. Atlantic &c. R. Co. 86 Pa. St. 291; 5 W. N. C. 263; 5 Reporter, 661.

[166] Farlow v. Lea, 6 C. L. J. 195.

[167] Chandler v. Siddle, 3 Dill. (U. S.) 477; Day v. Postal Tel. Co. 66 Md. 354.

[168] Pond v. Cooke, 45 Conn. 126;

is appointed, and it be attached at the suit of a citizen before the receiver has taken possession of it, then the appointment of the receiver in a foreign state might not vest the property in him as against such creditor.[169]

A receiver will not be required to pay over money in a trustee or garnishment process, or by order of court, in a state other than that in which the receiver was appointed.[170]

In a proper case the courts will protect citizens of their own state against the claims of a receiver appointed by an extra-territorial court, because they are not bound by such appointment, and their assistance will not be given, at the expense of injustice to citizens of their own state, to enforce an extra-territorial act resting only in comity.[171]

29 Am. R. 668; 6 Reporter, 516; Killmer v. Hobart, 58 How. Pr. (N. Y.) 452.

[169] Chicago &c. R. Co. v. Packet Co. 108 Ill. 317; 48 Am. R. 557; Taylor v. Columbian Ins. Co. 14 Allen (Mass.), 353; Upton v. Hubbard, 28 Conn. 274; 73 Am. Dec. 670; Willitts v. Waite, 25 N. Y. 577.

[170] Smith v. McNamara, 15 Hun (N. Y.), 447.

[171] Chicago &c. R. Co. v. Packet Co. 108 Ill. 317; 48 Am. R. 557.

CHAPTER XV.

THE RIGHTS AND LIABILITIES OF A RECEIVER.

I. The title and power of a receiver in general, §§ 474–486.
II. A receiver cannot be sued without leave of the court appointing him, §§ 487–501.
III. A receiver's liability to suit for the negligence of his employees, §§ 502–516.
IV. The company itself is not liable after the receiver has assumed control, §§ 517–522.
V. Discharge and removal of receiver, §§ 523–530.
VI. Compensation and account of receiver, §§ 531–540.

I. *The Title and Power of a Receiver in General.*

§ 474. The right of a receiver to property placed in his charge relates back to the date of the order of his appointment. The order of the court, either impliedly or expressly, takes the title from the defendant, and it is henceforth under the control of the court; and whether he be immediately appointed and qualified to act or not, the title of the court and of its agent and officer dates from that moment.[1] The title to real estate vests in the receiver only by conveyance from the debtor, which the court may compel him to make;[2] but he is entitled to the rents and profits from the date of the order

[1] Steele v. Sturges, 5 Abb. Pr. (N. Y.) 442; Rutter v. Tallis, 5 Sandf. (N. Y.) 610; Fairfield v. Weston, 2 Sim. & St. 96; Maynard v. Bond, 6 Reporter, 530. And see Metz v. Buffalo &c. R. Co. 58 N. Y. 61; Allen v. Central R. Co. 42 Iowa, 683. Contra, see Farmers' Bank v. Beaston, 7 G. & J. (Md.) 421.

[2] Chautauqua Co. Bank v. Risley, 19 N. Y. 369; Scott v. Elmore, 10 Hun (N. Y.), 68; St. Louis &c. Co. v. Coal &c. Co. 111 Ill. 32.

appointing him, which in effect removes the defendant or other person from the possession unless he holds under a title paramount to that under which the appointment was made.[3] The treasurer of a corporation refusing to obey the order of court to turn over the money or other property of the corporation in his hands to the receiver is guilty of a contempt of court.[4]

The right to the custody of the property of which a receiver is appointed vests immediately in him upon the filing of his bond; and he may, if necessary, by order of court, bring a suit for it in his own name. But the right of possession extends only to the property which is the subject-matter of the mortgage. It does not extend to money in the hands of the mortgagor at the time the appointment is made, for although it be earnings of the road, the mortgage does not attach to it.[5] If, after such order appointing a receiver and the execution of such bond, earnings of the road be seized on execution by a creditor, he is entitled to hold them in preference to the trust creditors. The mortgage attaches to such earnings only from the time possession is taken of them in behalf of the bondholders.[6]

If, however, the order appointing a receiver be conditional on his giving security, it would seem that he is not constituted receiver till he gives security; and that till he gives such security, or takes actual possession, it is not contempt of court to take chattels comprised in the security in execution.[7] If the receiver really takes possession before the goods are seized, then, although his appointment as receiver had not been completed, still, as possession is taken on behalf of the mortgagee, it would seem that it would be effectual against any interference by execution.[8]

Relief from interference with assets belonging to a receiver may be obtained by petition instead of by bill against the wrongdoer,

[3] Ames v. Birkenhead Docks, 20 Beav. 332, 350; Evelyn v. Lewis, 3 Hare, 472; Lloyd v. Mason, 2 Myl. & Cr. 487.

[4] Edrington v. Pridham, 65 Tex. 612; American Const. Co. v. Jacksonville &c. R. Co. 52 Fed. 937.

[5] Noyes v. Rich, 52 Me. 115; Rider v. Vrooman, 12 Hun (N. Y.), 299.

[6] Frayser v. Richmond &c. R. Co. 81 Va. 388.

[7] Edwards v. Edwards, L. R. 2 Ch. D. 291, overruling V. C. Malins, that the appointment takes effect from the date of the order; L. R. 1 Ch. D. 454.

[8] Edwards v. Edwards, L. R. 2 Ch. D. 291, per Mellish, L. J.

and it matters not whether such assets have ever been in the receiver's possession,[9] or that the proposed defendant was not a party to the original suit.[10]

474a. An order for the delivery of "all and every part of the premises, interests, effects, moneys, receipts, and earnings" etc., to a receiver, has been held to include the corporate seal. Such an order includes all books relating to the previous history of the corporation and all records of its transactions, and is not confined to books relating to future operation of the road.[11]

§ 475. The court in which the receiver was appointed is the proper tribunal to direct and control the receiver in the management of the property, and any application for this purpose should be made in the same cause. An application in another court or in another cause to compel a receiver to operate the railroad of which he is the receiver will be denied.[12]

The validity of a receiver's act in selling or exchanging the property in his possession cannot be questioned in a collateral suit in another court. If the court whose officer he is has approved his accounts, discharged him, and cancelled his bond, it must be assumed that it authorized and approved his act.[13]

The court may after the appointment of a receiver allow the corporation to bring a suit in its name against any one, except the receiver, to try the legal title to property claimed by the corporation.[14]

It is proper and competent for a court to adjust difficulties between a receiver and his employes which in the absence of such adjustment, would tend to injure the property and defeat the purpose of the receivership.[15]

The appointment of a receiver does not interfere with the right of the corporation to control its corporate existence. It has the right, after such appointment as before, to hold meetings and to

[9] Bibber-White Co. v. White River Val. E. R. Co. 107 Fed. 176.

[10] Lake Shore &c. R. Co. 103 Fed. 227.

[11] American Const. Co. v. Jacksonville &c. R. Co. 52 Fed. 937.

[12] People v. McLane, 62 Cal. 616.

[13] Bradly v. Marine &c. Co. 3 Hughes (U. S.), 26.

[14] St. Louis Coal &c. Co. v. Coal &c. Co. 111 Ill. 32.

[15] Waterhouse v. Comer, 55 Fed. 149.

elect directors.[16] Such a corporation has the right to appear in proceedings connected with the receivership by counsel employed without cost to the estate in the hands of the receiver.[17]

475a. When authorized by order of court to continue the business of a railroad company, receivers are clothed with substantially the same powers and are subject to substantially the same liabilities as the original company and in the exercise of such powers, they may contract for transportation beyond the lines of their road and assume liability for the entire distance over connecting lines.[18]

§ 476. A receiver takes the property subject to any legal or equitable liens upon it at the time of his appointment.[19] Thus money deposited by a railroad company with bankers for the payment of a dividend is regarded as specially appropriated for that purpose, and as giving the stockholders an equitable lien upon it to the extent they are respectively entitled to share in it; and a receiver appointed before the whole amount deposited has been paid out takes such funds subject to this equity. The Erie Railway Company having so deposited the amount of a dividend payable October first, 1873, a little more than a year afterwards withdrew a balance of about $5,000, which had not been paid out, and this sum passed into the hands of a receiver appointed soon afterwards. A stockholder who has been absent and had neglected to draw his dividend applied to the court by petition for an order directing the receiver to pay him the amount of his dividend, and such an order was made and was confirmed by the Supreme Court of New York at general term.[20]

The appointment of a receiver does not enlarge or restrict the powers conferred upon the corporation by its charter. The re-

[16] Taylor v. Phila. &c. R. Co. 14 Phila. (Pa.) 451, 468.

[17] Johnson v. Southern &c. Ass. 99 Fed. 646.

[18] Farmers' &c. Co. v. Northern Pac. R. Co. 120 Fed. 873.

[19] Bell v. Shibley, 33 Barb. (N. Y.) 610; Gere v. Dibble, 17 How. Pr. (N. Y.) 31; Snow v. Winslow, 54 Iowa, 200; 6 N. W. 191. As to rights of set-off see Berry v. Brett, 6 Bosw. (N. Y.) 627; State v. Railway Commissioners, 41 N. J. L. 235; State v. Superior Court, 8 Wash. 210; 35 Pac. 1087.

[20] Le Blanc, In re, 4 Abb. N. C. (N. Y.) 221.

ceiver takes the property subject to the same limitations that affected it in the hands of the company.[21] An injunction granted by a court of competent jurisdiction restraining a railroad company from obstructing certain streets is binding upon a receiver subsequently appointed by a court of the United States, in the same manner that it is binding upon an agent of the company or upon a subsequent purchaser.[22]

§ 476a. **Every lien upon the property of a corporation resting upon valid agreement or process before the appointment of a receiver,** the lienor being lawfully in possession, must be preserved with the right of enforcement. Hence under a statutory proceeding for the voluntary dissolution of a corporation, no express power being conferred by the statute, a court cannot restrain the creditors of the corporations from disposing of its bonds, held as collateral to loans under lawful contracts empowering them to sell.[23]

§ 476b. **A court of the United States will not permit its receiver to do any unlawful act,** nor any act which amounts to a violation or breach of the peace; and when such act first comes to the knowledge of the court, and at the first opportunity, regardless of any technical pleading, the court will make such orders as provide for full restitution, and will not permit its receiver to continue his unlawful act or obtain any advantage thereby. The court properly holds that its officer, clothed with power from the court, shall not use that power oppressively or unlawfully, but that, as such officer, he is under the highest obligation at all times to set an example of obedience to law and of the pursuit of strictly peaceable methods in his conduct.[24]

§ 477. **If a receiver collects moneys under a pooling contract with another railroad company, he must account for them in accordance with the contract,** without regard to the validity of the

[21] State v. Railway Commissioners, 41 N. J. L. 235; Harland v. Bankers' &c. Co. 32 Fed. 305.

[22] Safford v. People, 85 Ill. 558.

[23] In matter of Bingham Gen. Elec. Co. 143 N. Y. 261; 38 N. E. 297.

[24] Chattanooga &c. R. Co. v. Felton, 69 Fed. 273.

contract. "The question in such a case is not whether an unperformed and executory contract shall be enforced, nor whether damages shall be recovered against a party who refuses to operate under it. It is whether one party, who has received all the expected benefits to be derived from it, shall account for the fruits of its performance, which by its terms belong to another, and which, contrary to its terms, it retains."[25]

§ 478. **If property not covered by mortgage is taken possession of by receivers together with the mortgaged property,** and they receive the profits and income from the entire property for a number of years under the general orders of the court, and without objection from the parties or creditors interested in the property not covered by the mortgage, the net profits obtained by the receivers should be apportioned between the mortgagees and the general creditors,—the former being entitled to the portion obtained from the use of the mortgaged property, and the latter to the residue arising from the use of the property not covered by the mortgage.[26]

The jurisdiction possessed by a court of chancery to foreclose a mortgage and to appoint a receiver for the mortgaged property pending the foreclosure gives it no jurisdiction or power to take into its custody, through a receiver or otherwise, property of the debtor which is not covered by the mortgage.[27] Where property in the hands of receivers is claimed by persons not parties to the suit in which the receivers were appointed, the proper procedure is to file a petition asking the court for an order on the receiver for delivery of the property.[28]

§ 479. **Suits by receivers.**—A receiver represents the creditors of the corporation whose property and effects he is placed in charge of by a court of equity, so that, in a suit brought by the receiver to protect the property of the company, the creditors are neither proper nor necessary parties.[29] While in bringing an action he should al-

[25] Central Trust Co. v. Ohio C. R. Co. 23 Fed. 306, 310, per Matthews, J.

[26] Lehman v. Tallassee Mfg. Co. 64 Ala. 567.

[27] Scott v. Farmers' &c. Co. 69 Fed. 17.

[28] Winchester v. Davis Pyrites Co. 67 Fed. 45.

[29] Gray v. Davis, 1 Woods (U. S.), 420. See McNab v. Noonan, 28 Wis. 434.

lege his appointment by a court of competent jurisdiction, and his authority to prosecute the action in his official capacity,[30] the regularity or propriety of his appointment cannot be called in question in such suit, but only in a direct proceeding for that purpose.[31]

In general, a receiver cannot sue without express authority from the court.[32] Even if the order of appointment in general terms confers the power to sue, it is usual and proper for a receiver before instituting a suit to obtain leave of court to do so.[33]

A receiver of a corporation has all the rights of action and the same legal remedies against third persons that the corporation itself had.[34] Where the cause of action accrued to the corporation before the receiver was appointed, the suit should be in the name of the corporation in which the right of action was before his appointment, in the absence of authority by statute to sue in his own name.[35] If the defendant or other person in possession of the property refuses to deliver it to the receiver, before attempting to take possession he should obtain an express order of court directing him to do so. If a third person holds the property under a claim of right, the receiver may obtain leave to bring an action to try such right, or the plaintiff in the suit in which the receiver is appointed may make such third person a party to the suit, and apply to have the receivership extended over the property in dispute.[36]

A receiver may be allowed to maintain an action to determine the validity of bonds claimed to be secured by a prior mortgage on the property, so that the extent of the lien may be known.[37]

§ 480. The receiver is the proper party in whose name suits

[30] Curtis v. McIlhenny, 5 Jones (N. C.), Eq. 290.

[31] Vermont &c. R. Co. v. Vermont Cent. R. Co. 46 Vt. 792; Palmer v. Clark, 4 Abb. N. C. (N. Y.) 25; Case v. Marchand, 23 La. Ann. 60.

[32] Screven v. Clark, 48 Ga. 41.

[33] High Receivers, § 208; Hayes v. Brotzman, 6 Reporter, 493; 46 Md. 519.

[34] High Receivers, § 316; Frankle v. Jackson, 30 Fed. 398.

[35] Booth v. Clark, 17 How. (U. S.) 322, 331; Yeager v. Wallace, 44 Pa. St. 294; Manlove v. Burger, 38 Ind. 211; Garver v. Kent, 70 Ind. 428. Under the Code system, a receiver may generally sue in his own name. Gray v. Lewis, 94 N. C. 392.

[36] Parker v. Browning, 8 Paige (N. Y.), 388; 35 Am. R. 717n.

[37] Hubbell v. Syracuse Iron Works, 42 Hun (N. Y.), 182.

should be conducted, either by or against the corporation whose property and affairs he is in charge of;[38] though a receiver who has no title to the property, but only a right of possession, must bring suits to recover property intrusted to his custody in the name of the corporation having the title, upon leave obtained for that purpose.[39]

Such receiver cannot maintain a suit in equity in his own name to obtain an adjudication that certain real property is subject to the lien of the mortgage, and that all liens claimed thereon by parties in possession and parties out of possession are invalid against him, and to obtain possession thereof against one claiming adversely, where neither the mortgagor nor the mortgagee is made a party, unless the receiver can show an assignment from them to him of the property or cause of action.[40]

A request by stockholders for action by the receivers is not complete until it reaches the court itself, to which the receivers are responsible. Neglect of such a request cannot justify a stockholder in usurping the receivers' functions, it being a fundamental doctrine that the stockholder must have exhausted reasonable effort to cause action to be taken by the proper managers of the company's affairs. Such reasonable effort is not exhausted until the court has been asked to act or to direct action by the receivers.[41] On the same principle a creditor of a corporation which is in the hands of a receiver cannot sue to set aside a fraudulent conveyance.[42]

§ 481. **A receiver cannot be put in possession of property claimed to belong to the corporation, but in the possession of another, by a summary order** made in the action in which he was appointed. Though the receiver charges that the books of the corporation are in the possession of a new corporation having the same officers as the old, and not organized in good faith, the court cannot deprive that corporation of the possession of the books by a summary order; but

[38] Frankle v. Jackson, 30 Fed. 398.

[39] Harland v. Bankers' &c. Co. 32 Fed. 305; Yeager v. Wallace, 44 Pa. St. 294.

In Pennsylvania a receiver of a corporation has no title to the property, but is a mere custodian of it; and not being invested with the title he cannot maintain a suit in his own name, but only in the name of the corporation. Dick v. Struthers, 25 Fed. 103.

[40] Harland v. Bankers' &c. Co. 32 Fed. 305; 33 Fed. 199.

[41] Swope v. Villard, 61 Fed. 41[illegible]

[42] Werner v. Murphy, 60 Fed. 769.

the receiver must institute some proceeding, to which the new corporation must be made a party, so that the question of ownership may be properly tried and determined.[43]

§ 482. Relation of the receiver to leases of the property. Whether a receiver can refuse to operate a road leased to the corporation whose property has been put under his control is a question important for him to consider when the leased road can be operated only at loss. If the mortgages under which he has been put in possession of the road are older than the lease, the mortgagees are not bound by it unless they have assented to it, and a receiver in such case may disregard the lease. The receiver may operate the leased road in such case temporarily, and under notice to all parties interested that he declines to assume the lease without becoming responsible beyond a reasonable sum for use and occupation; and he will be accountable for this to the lessor, and not to his assignee.[44] But where, on an application by motion to compel a receiver to comply with the terms of a lease to the corporation in his charge, he set up his appointment and denied that he was then operating the road or had operated it under the lease, the court will not on such motion try and settle a disputed question of law and fact. The rights of the parties should be settled in an action. The mortgage bondholders, whose moneys it is sought to divert to the payment of the rent of the leased road, or their trustees, should be made parties to such a suit.[45]

A lease invalid in the beginning may be afterwards ratified by the corporation by the payment of rent or otherwise. If, however, it was one which the company had no power to make, it cannot be ratified.[46]

A receiver of the Southern Minnesota Railroad Company appointed in a foreclosure suit was authorized to enter into a contract with a bridge company for the payment of fixed tolls for the use of the bridge for a series of years, binding the company, its assigns or suc-

[43] Olmsted v. Rochester &c. R. Co. 46 Hun (N. Y.), 552.

[44] Milwaukee &c. R. Co. v. Brooks Locomotive Works, 121 U. S. 430; 7 Sup. Ct. 1094.

[45] People v. Erie R. Co. 54 How. Pr. (N. Y.) 59.

[46] Ogdensburgh &c. R. Co. v. Vermont &c. R. Co. 4 Hun (N. Y.), 268.

cessors, or the purchasers at the foreclosure sale under the deed of trust.[47]

Without authority conferred by statute or order of court, a receiver has no power to make leases other than parol. But a court having possession of property through its receiver may authorize him to lease it. Such lease should not be for too long a term, and a privilege of cancellation ought sometimes to be inserted, for if the lessee is ousted by order of court before the end of the lease, damages must be awarded him.[48]

A receiver of a railroad under the appointment of the governor of a state has no power to lease the road so as to vest the lessee with an interest in the road and its franchises which could not be divested by a subsequent act of the legislature.[49]

Such is the authority of a court of equity over corporations in the charge of receivers that, as between two railroad companies in the hands of receivers, upon the application of either receiver, a contract between the companies for the use of part of one road by the other company, and for the use of terminal facilities, may be modified so as to equitably readjust the rates agreed upon between them. If the application shows that at the time when the contract was made rents, tolls, equipments, and all kinds of labor and material were much more expensive than at present, and that the rate established by the contract is excessive and unjust, the court is not bound to recognize the obligation of the contract, but may modify it if it can be done with due regard to the interest of the other trust. "It will not require the receiver of one railroad company to furnish facilities to the receiver of another in the operation of the road in charge of the latter, to the detriment of the trust in the hands of the former; but, if there be necessity for so doing, it will not hesitate to modify the terms on which the facilities are furnished, wholly ignoring, if need be, the bargain made between the two insolvent companies, always taking care, however, that the company furnishing the facilities receives due compensation therefor."[50]

[47] La Crosse Railroad Bridge, In re, 2 Dill. (U. S.) 465.

[48] Farmers' &c. Co. v. Eaton, 114 Fed. 14.

[49] McMinnville &c. R. Co. v. Huggins, 3 Baxt. (Tenn.) 177.

[50] New Jersey &c. R. Co. In re, 29 N. J. Eq. 67, 69. See, also, Delaware &c. R. Co. v. Erie R. Co. 21 N. J. Eq. 298.

§ 483. Liability of receiver for rental of leased lines.—The fact that a receiver, appointed on the application of a mortgagor, takes possession of lines of road leased to the company of which he is made receiver, does not make him an assignee of the leases, so as to make the rentals due under such leases prior to the claims of mortgagees who had never assented to such leases.[51] But if the mortgagees themselves, in proceedings to foreclose a mortgage, procure the appointment of receivers, and cause them to take possession of property held under lease by the mortgagor, to which this mortgage does not extend, they thereby bind the mortgaged property for the payment of rent so long as the receiver remains in possession.[52] Whether the receivers take the earnings as lessees or in any other capacity, they are bound to disburse them in accordance with the terms of the instrument under which the earnings are received.[53]

A receiver will ordinarily be ordered to pay the rental of a leased road which is earning more than the operating expenses. But an order directing such payment may be subject to an order made at the time of the appointment of the receiver for the payment of preferential debts for operating expenses.[54] Where a leased road is surrendered by the receivers as soon as the lessor would take it, the accrued rental is not an expense originating in the process of administration by the court, and cannot be made a preferred claim to be charged against the *corpus* of the property in preference to the mortgagee's claim.[55]

If a subdivision of a leased railroad in the hands of a receiver earns no surplus, but simply pays operating expenses, no rental or

[51] Central Trust Co. v. Wabash &c. R. Co. 34 Fed. 259; Ames v. Union Pacific R. Co. 60 Fed. 966; Empire Dist. Co. v. McNulta, 77 Fed. 700. Compare Dayton Hydraulic Co. v. Felsenthall, 116 Fed. 961; Carswell v. Farmers' &c. Co. 74 Fed. 88.

[52] Central Trust Co. v. Wabash &c. R. Co. 34 Fed. 259, per Thayer, J.; Woodruff v. Erie R. Co. 93 N. Y. 609; Miltenberger v. Logansport Railway Co. 106 U. S. 286; 1 Sup. Ct. 140.

[53] Clyde v. Richmond & D. R. Co. 63 Fed. 21.

[54] Central Trust Co. v. Wabash &c. R. Co. 38 Fed. 63; Central Trust Co. v. Wabash &c. R. Co. 23 Fed. 863; Central R. & Banking Co. v. Farmers' &c. Co. 79 Fed. 158.

[55] Quincy &c. R. Co. v. Humphreys, 145 U. S. 82; 12 Sup. Ct. 787.

interest on such subdivision will be paid. If the lessor desires possession, he should have liberty to assert his rights. The court will continue to operate such subdivision until the lessor takes some action, because the entire system should be preserved, and if any disruption comes, it should come from those who have a legal right to make it.[56]

§ 483a. That a receiver can never be compelled to take possession of leased lines as assignee has been declared to be the better view. The one case[57] holding that, where a receiver is appointed to preserve a railway system intact, he takes possession of leased lines as assignee, has been discredited. Woods, J.,[58] said of it: "It is true that in Brown v. Railroad Co. it was held that these receivers, by taking possession of leased lines under the order of the court, became assignees of the lease, and, as such, liable for the rent; . . . and while the doctrine of it is, perhaps, the established rule of cases which involve only private rights, the reported decisions show that it has seldom, if ever, been deemed applicable to receivers of railroads."

The mere appointment of receivers and their taking possession of a leased road under order of court does not, even if the receivership is for the purpose of preventing a disintegration of the system, render them assignees of the lease, or require their adoption of it so as to make rental a preferred claim. Continued occupation of the leased line does not work an adoption of the lease, when the lessor has never demanded a surrender.[59]

If a receiver elects to adopt a lease, he becomes vested with the title to the leasehold interest, and a privity of estate is thereby created between the lessor and the receiver by which the latter becomes liable upon the covenants to pay rent.[60]

[56] Central Trust Co. v. Wabash &c. R. Co. 23 Fed. 863.

[57] Brown v. Toledo &c. R. Co. 35 Fed. 444.

[58] Central Trust Co. v. Wabash &c. R. Co. 46 Fed. 26, 32; New York &c. R. Co. v. New York &c. R. Co. 58 Fed. 268.

[59] New York &c. R. Co. v. New York &c. R. Co. 58 Fed. 268; Park v. New York &c. R. Co. 57 Fed. 799.

[60] United States Trust Co. v. Wabash &c. R. Co. 150 U. S. 287; 14 Sup. Ct. 86.

§ 483b. Liability of receiver upon executory contracts made prior to appointment.—It has been held by a federal court, applying the law of the district where it was sitting, that executory contracts by a railway company become nugatory upon the appointment of a receiver, unless they are adopted by the receiver. By this rule the contracting party is not entitled to damages as for a breach of such contract, but is only entitled to a just compensation for actual expenditure.[61]

§ 483c. Receivers are allowed a reasonable time to elect whether they will assume any of the corporation's executory contracts, such as a lease, meanwhile exercising the company's rights under it for the purpose of such determination. A receiver is obliged to take possession of a leasehold estate, if it be included within the order of the court, but he does not thereby become the assignee of the term or liable for the rent, but holds the property as the hand of the court, and is entitled to a reasonable time to ascertain its value, before he can be held to have accepted it as lessee.[62] The ordinary chancery receiver is clothed with no estate in the property, but is a mere custodian of it for the court. The scope of his duties and powers is much more restricted than that of an assignee in bankruptcy or insolvency.[63]

Where formal action to declare a forfeiture because of non-payment of rent which matured prior to the receivership is not taken till after a receiver is appointed and within a few days after the expiration of the time for making such payment as fixed in the lessor's notice, the payment is made by the receivers, and received and retained by the lessor, the court creating the receivership will not enforce the forfeiture.[64]

The rule seems to be general that receivers are not liable on executory contracts of the corporation, unless they adopt or ratify such

[61] Tennis Bros. v. Wetzel R. Co. 140 Fed. 193.

[62] Quincy &c. R. Co. v. Humphreys, 145 U. S. 82; 12 Sup. Ct. 787; 36 L. Ed. 632; St. Joseph &c. R. Co. v. Humphreys, 145 U. S. 105; 12 Sup. Ct. 795; United States Trust Co. v. Wabash R. Co. 150 U. S. 287; 14 Sup. Ct. 86; Sunflower Oil Co. v. Wilson, 142 U. S. 313; 12 Sup. Ct. 235.

[63] Farmers' &c. Co. v. Northern Pac. R. Co. 58 Fed. 257; Gaither v. Stockbridge, 67 Md. 222.

[64] Johnson v. Lehigh Valley &c. Co. 130 Fed. 932.

contracts.[65] In accordance with this principle, it has been held that a receiver is not bound by a contract with an intersecting road to put in a system of interlocking switches. The bondholders were not bound by this contract, either as a contract running with the land or on the theory of a vendor's lien, or of a condition of the grant.[66] Even where freight was paid in advance for the transportation of goods, the contract could neither be enforced specifically nor could the payment be recovered back, as against a receiver who was put in charge of the road.[67] And on the same principle a receiver is not bound by a contract made by his predecessors for a rebate of freight charges.[68]

§ 483d. **A fortiori a receiver is not liable for a tort** committed by the corporation prior to his appointment, and not being liable therefor, it necessarily results that the receiver is not a proper party to an action to recover damages based on such a claim.[69]

§ 484. **Whether a receiver may disregard traffic rates.**—While the constitutionality of a state statute regulating freight and passenger tariffs was pending before the Supreme Court of the United States, Judge Dillon, in the Circuit Court, declined to order the receiver to disregard the law, or to conform to it in all things.[70] While there is always a presumption in favor of the validity of an act of the legislature, and that the receiver would be justified in following the state statute in all instances where the rates fixed by it are reasonable and fairly compensatory to the company, yet the judge said that the receiver might exercise a fair and impartial judgment in the matter; and if he should be of the opinion that the rates fixed by the statute are unjust and unreasonable, he was at liberty to act for the time being under the direction and advice of the mortgage trustees, who are the persons having the most at stake in the

[65] Northern Pac. R. Co. v. Heflin, 83 Fed. 93; Electric Co. v. Whitney, 74 Fed. 664; 20 C. C. A. 674; United States Trust Co. v. Wabash R. Co. 150 U. S. 287; 14 Sup. Ct. 86.

[66] Manhattan Trust Co. v. Sioux City &c. R. Co. 81 Fed. 50.

[67] Central Trust Co. v. Marietta &c. R. Co. 51 Fed. 15.

[68] Kansas Pac. R. Co. v. Bayles, 19 Colo. 348; 35 Pac. 744.

[69] Northern Pac. R. Co. v. Heflin, 83 Fed. 93.

[70] McElrath, In re, 2 Dill. (U. S.) 460.

matter. No harm would come from this course, as the funds would be in the control of the court; and if it should turn out that they had been improperly received, they would be restored to the parties who had overpaid.

Furthermore, a receiver, not being bound to continue contracts made before his appointment, is not criminally liable under a statute for the violation of a joint tariff rate, which he has not adopted or recognized in any way.[71]

§ 485. Payments within the discretion of a receiver.—It is a well-recognized principle that a receiver should not, without the previous direction of the court, incur any expenses, on account of the property in his hands, beyond what is absolutely essential to its preservation and use.[72] In all matters involving a large outlay of money, the receiver should apply to the court in advance for authority to make the proposed expenditure; but, except in extraordinary cases, the submission by the receiver, at frequent intervals, of his accounts to the master, giving the latter an opportunity to disallow whatever he may not approve, is regarded as a sufficient reference to the court for its ratification of the receiver's proceedings.[73] All outlays of a receiver of a railroad made in good faith, in the ordinary course of the management and operation of it, or so made with a view to advance and promote the business of the road, and make it profitable and successful, are fairly within the limit of discretion necessarily allowed him. Thus, payments made by him as rebatements of freight to shippers, in order to secure their custom and increase the business of the road, being in the nature of drawbacks, such as are usual with transportation companies, are properly within his discretion.[74]

[71] United States v. DeCoursey, 82 Fed. 302.

[72] Cowdrey v. Galveston &c. R. Co. 93 U. S. 352; 9 Am. Railw. R. 361; Wabash &c. R. Co. v. Central Trust Co. 22 Fed. 269.

A receiver, without the previous sanction of the court, may incur ordinary expenses in the daily administration of railroad property, but the courts decline to sanction the exercise of this discretion in respect to large outlays or contracts extending beyond the receivership. Chicago Deposit V. Co. v. McNulta, 153 U. S. 554; 14 Sup. Ct. 915.

[73] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331; Coe v. New Jersey Midland R. Co. 27 N. J. Eq. 37.

[74] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331.

In accordance with this rule, a receiver is not allowed to charge in his account for expenditures made by him to defeat a proposed subsidy from a city to aid in the construction of a parallel line of railway, or to defeat any contemplated aid for such an enterprise. Although the proposed line of road might diminish the future earnings of the road in his charge, he is not allowed to determine for himself the question of the advisability of the expenditure, or to appropriate funds in his charge to defeat the measure.[75]

The earnings of a railway company in the hands of a receiver are chargeable with valid claims for goods lost in transportation, and for damage done to them, while the road is under the management of the receiver. Such losses are incident to the working of the road, and may be regarded as part of the ordinary expenses of working it. The bondholders are entitled only to what remains of the earnings of the road after charges of this kind and other expenses of management are paid.[76]

§ 485a. Interest accruing on first mortgage bonds may be paid by a receiver under a second mortgage at the direction of the court. It was argued for first mortgage bondholders that by an application of the earnings to the payment of their interest, they would lose the right to foreclose their mortgage, but this argument was declared to be barren of equity. Their debt is not due, and they have no right to foreclose as long as interest is not in default. To say that by applying earnings to the payment of their interest, and thereby preventing foreclosure, is to work an injury to them, is an indefensible position. The first mortgagee is not an actor in this litigation. The debtor railroad company, by paying interest as it matures, can prevent a foreclosure of the first mortgage. That company makes no objection to the application of the earnings in the hands of the receiver to the payment of the unquestioned debt due from it and an undoubted first lien upon its property. Holders of second mortgage bonds have no grounds whatever to object to the payment of that interest, because that interest is, in any event, to

[75] Cowdrey v. Galveston &c. R. Co. 93 U. S. 352; 9 Am. Railw. R. 361.

[76] Cowdrey v. Galveston &c. R. Co. 93 U. S. 352; 9 Am. Railw. R. 361. See §603.

be paid before they can receive anything from the *corpus* of the property.[77]

§ 486. Contracts entered into by receivers with authority should be strictly fulfilled. Thus where a railroad company contracted for rails, and before they were delivered became insolvent and receivers were appointed, who, in order to avoid litigation, and with the expectation of earning freight by transporting ores for the vendor, agreed to receive the rails and pay the contract price, though this was more than the market price of the rails at the time, it was held that the receivers should comply with their agreement, though they were disappointed in their expectation of earning anything by transporting ores for the vendor.[78] Brewer, J., in delivering the decision, said: "I think that any person who deals with the officers of this court as to certificates or contracts should feel certain that there is no more sacred obligation than that upon the part of the court to see that these contracts are carried out in letter and spirit, so that any one dealing with them can depend upon them."

§ 486a. Where a receiver petitions for a reduction of employes' wages, the employes concerned should be notified, and accorded a hearing. Where wages are not excessive for the labor performed, and are not higher than the wages paid to like employes on similar lines, the court will not order a reduction because of inability of the railroad to pay interest on dividends.[79]

II. *A Receiver cannot be sued without leave of the court appointing him.*

§ 487. In general.—A receiver appointed by a court of equity to take charge of and manage property while litigation is pending touching such property is but the hand of the court to hold possession of and manage the property under the direction of the court,

[77] Lloyd v. Chesapeake &c. R. Co. 65 Fed. 351.

[78] Wabash &c. R. Co. v. Central Trust Co. 22 Fed. 269, 272.

[79] United States Trust Co. v. Omaha &c. R. Co. 63 Fed. 737.

and is not supposed to act in the interest of one party more than another. He holds and manages the property for the benefit of the party to whom the court may adjudge it; and acting in this fiduciary capacity only, he is not subject to suit by any party who may have complaint against him, without leave first obtained from the court appointing him.[80] While property is in possession of a court of the United States through its receiver, all proceedings in a state court affecting it without authority of the federal court are void. This statement applies not only to ordinary suits, but to every kind of legal proceeding affecting the property. Thus, while a railroad is in the possession of a receiver of a court of the United States, a telegraph company can acquire no title to a right of way over the line of the railroad by proceedings for condemnation in a state court.[81]

A receiver should object that leave to sue him was not first obtained, before voluntarily submitting to the authority of the court in which suit is brought and joining issue. After appearing and answering without objection, it is too late for him to urge the objection.[82]

Objection was made in the Supreme Court of the United States that a junior mortgagee could not file a bill of foreclosure without leave, while the mortgaged premises were at the time in the possession of a receiver appointed in a former suit in the same court. In reply to this, Mr. Justice Strong said:[83] "If there could, under any circumstances, be any force in this objection, there is none now. Both suits were brought in the same court; these appellants appeared, answered, and cross-examined witnesses, and made no allegation that the suit had been brought without leave until about a year and a half afterwards. It was then too late. They must be

[80] Hale v. Duncan, 6 Wash. L. R. 285; 6 Reporter, 422; Heath v. Missouri &c. R. Co. 83 Mo. 617; Jones v. Browse, 32 W. Va. 444; 9 S. E. 873; Andrews v. Stanton, 18 Ill. App. 163; Smith v. St. Louis &c. R. Co. 151 Mo. 391; 52 S. W. 378; 48 L. R. A. 368n. But this rule applies only to property of which the receiver has actual or constructive possession. Kidder v. Beavers, 33 Wash. 635; 74 Pac. 819.

[81] Western Union &c. Co. v. Atlantic &c. Co. 7 Biss. (U. S.) 367.

[82] Elkhart Car Works Co. v. Ellis, 113 Ind. 215; 15 N. E. 249; Roxbury v. Central Vt. R. Co. 4 Railw. & Corp. L. J. 204.

[83] Jerome v. McCarter, 94 U. S. 734, 737.

held to have acquiesced; and, if not, leave of the court to commence and prosecute the suit must be presumed after the orders made to facilitate its progress."

§ 488. **In what courts a receiver may be sued.**—The court under which the receiver is acting may take cognizance of the question of the receiver's liability for his official acts, or may permit the party aggrieved to sue at law, unless the jurisdiction of the court in the matter be assailed, in which case it must assume exclusive jurisdiction.[84] As a general rule, receivers are amenable solely to the court by which they are appointed; but this rule does not apply when citizens of another state seek remedy against them in such other state, and the receiver's liability has already been determined by the courts of the state in which he was appointed.[85] Ordinarily, however, a receiver cannot be sued for assets in his hands without first obtaining leave of the appointing court.[86] But the decree of court appointing a receiver entitles him to protection in the possession of such property only as he is entitled to take possession of. When he takes possession of property to which he has no claim, he is not acting as the officer or representative of the court, but as a mere trespasser. The rightful owner of a locomotive engine, which a railroad company in the hands of a receiver never had any interest in, may take possession of it by a replevin suit, without first obtaining leave of the court appointing the receiver, although the engine is, at the time, used upon the road.[87]

The court, whose officer a receiver is, may restrain persons within its jurisdiction from prosecuting suits in foreign courts, whereby

[84] Klein v. Jewett, 26 N. J. Eq. 474; Meara v. Holbrook, 20 Ohio St. 137; 5 Am. R. 633; Massachusetts &c. Co. v. Chicago &c. R. Co. 13 Fed. 857; Reed v. Axtell, 84 Va. 231; 4 S. E. 587; 33 Am. & Eng. R. Cas. 503.

As to service of process upon receivers, see Lewis v. Seifert, 116 Pa. St. 628; 11 Atl. 514.

If, during the pendency of a suit against a receiver, brought with permission of the court appointing him, he resigns, it is not necessary to obtain permission to prosecute it against his successor. Fordyce v. Dixon, 70 Tex. 694; 8 S. W. 504.

[85] Paige v. Smith, 99 Mass. 395.

[86] De Graffenried v. Brunswick &c. R. Co. 57 Ga. 22; Barton v. Barbour, 104 U. S. 126; Davis v. Gray, 16 Wall. (U. S.) 203; Melendy v. Barbour, 78 Va. 544.

[87] Hills v. Parker, 111 Mass. 508; 15 Am. R. 66.

the earnings of a railroad in the hands of a receiver are locked up by attachment or trustee process.[88] The court in such case acts upon the ground that the party upon whom the order is made is within the jurisdiction of the court; that the receiver, as the officer of the court, is entitled to protection while in the proper discharge of his duty; and that persons interfering with his collecting the earnings of the road in his possession are guilty of contempt of court.

Both the American and English doctrine is, that a receiver is an officer of the court, his possession the possession of the court, and that without leave of such court no action can be maintained against him.[89] Consequently apart from statute, a receiver is not subject to garnishment except by consent of the court appointing him.[90]

§ 489. This rule applies both to suits for the recovery of money demands and those for the recovery of damages for injuries to persons or property, as well as to those whose object is the recovery of property which the receiver holds under the order of his appointment. The effect of permitting a suit to be brought without leave might be in either case to take the property of the trust from the receiver's hands and apply it to the payment of the plaintiff's claim, without regard to the rights of other creditors or the orders of the court which is administering the trust property. If the plaintiff may without leave prosecute his demand to judgment in another court, he could enforce satisfaction of it upon the property of the trust, unless restrained by injunction from the court administering the trust. That court cannot administer the trust unless it can control all litigation in respect to the trust property.[91]

[88] Vermont &c. R. Co. v. Vermont Central R. Co. 46 Vt. 792; Barton v. Barbour, 104 U. S. 126; 4 Am. & Eng. R. Cas. 1; 6 Wash. L. R. 41; 6 Cent. L. J. 201; Lyman v. Central Vermont R. Co. 59 Vt. 167; 10 Atl. 346; 30 Am. & Eng. R. Cas. 210.

[89] See article by Mr. High, 2 South. Law Rev. 576, October, 1876, and cases cited; Wiswall v. Sampson, 14 How. (U. S.) 52, 65; Davis v. Gray, 16 Wall. (U. S.) 203; Barton v. Barbour, 104 U. S. 126; 4 Am. & Eng. R. Cas. 1; Melendy v. Barbour, 78 Va. 544; 25 Am. & Eng. R. Cas. 622; Ames v. Birkenhead Docks, 20 Beav. 332; Hall v. Smith, 2 Bing. 156; Thompson v. Scott, 4 Dill. (U. S.) 508; Commonwealth v. Runk, 26 Pa. St. 235. See, however, Lyman v. Central Vermont R. Co. 59 Vt. 167; 10 Atl 346; 30 Am. & Eng. R. Cas. 210

[90] Central Trust Co. v. Chattanooga &c. R. Co. 68 Fed. 685.

[91] Barton v. Barbour, 104 U. S 126.

§ 490. **A court making the appointment of a receiver may draw to itself all controversies to which the receiver is a party**; yet it does this by acting directly upon the parties, and not by challenging the jurisdiction of other tribunals.[92] The mere fact of the appointment constitutes no plea to the jurisdiction of other courts; their ordinary jurisdiction is in no way affected by the appointment, in respect to matters in which the receiver may be interested, or which affect the property placed in his hands.[93] The court appointing the receiver is not thereby compelled to assume jurisdiction of all controversies to which the receiver may become a party, but may leave their determination to any court of appropriate jurisdiction.[94] It may assert its right to take all such controversies to itself by acting directly upon the parties, and compelling them to proceed nowhere else than in its forum. Its power is unlimited for purposes of protection to restrain by injunction all suits in other courts against the receiver, or to punish, as for a contempt, any interference with its officers by force or by action, but it may use its discretion in this respect.[95] Thus a suit was brought in a court of the State of Kansas by a county treasurer against the St. Joseph and Denver City Railroad Company to recover certain taxes, after a receiver of the company had been appointed by the Circuit Court of the United States. The petition alleged the appointment of the receiver, and his possession and control of the road. Without the issue or service of any process the company and receiver filed a joint answer, in which they admitted that a portion of the taxes were properly chargeable against the company, and consented that judgment might be rendered against them in the action for that amount. They also alleged the appointment of the receiver by the United States Circuit Court, that he was not amenable to the process of the state court, and prayed that as to him the suit might be dismissed: but it was held that the state court had jurisdiction, and might properly ren-

[92] St. Joseph &c. R. Co. v. Smith, 19 Kans. 225; 6 Reporter, 331.

[93] Blumenthal v. Brainerd, 38 Vt. 402, 407; 91 Am. Dec. 349.

[94] Hills v. Parker, 111 Mass. 508; 15 Am. R. 63; St. Joseph &c. R. Co. v. Smith, 19 Kans. 225; 6 Reporter, 331.

[95] St. Joseph &c. R. Co. v. Smith, 19 Kans. 225; 6 Reporter, 331, per Brewer, J.; Kinney v. Crocker, 18 Wis. 74; Chautauqua County Bank v. Risley, 19 N. Y. 369; Central Trust Co. v. Wabash &c. R. Co. 23 Fed. 858.

der judgment against the receiver. It is to be presumed in such case that if the Circuit Court in its discretion deemed it best to draw to itself this controversy, it would have done so. Moreover, it would seem that the receiver, having voluntarily come into court, admitted that a part of the claim was due, and consented that judgment might be rendered against him, could not be allowed afterwards to question the jurisdiction of the court.[96]

If a receiver is appointed pending a proceeding in a state court to enforce a lien for labor and materials, and the plaintiff prosecutes his claim to judgment without leave, the court in which the receiver was appointed will not entertain a petition to have such judgment declared a lien on the property in the receiver's hands paramount to that of mortgage creditors.[97]

§ 491. **The court in which the original bill was filed, when ancillary bills have been filed** in other states through which the line of road extends, is the proper tribunal to which a creditor of the company should apply for an order against the receiver for the payment of his claim out of the earnings of the road.[98] It is the duty of an ancillary receiver, after paying the expenses of his receivership, to account with and remit to the receivers in the original jurisdiction all funds and assets in his hands.[99]

Original and ancillary receivers are to be treated as different legal persons in respect to judgments obtained against them for debts of the corporation, and also in respect to torts for which they are liable in connection with the management. Consequently an ancillary receiver is not liable for a tort committed by the original receiver in operating the road, and a petition cannot be maintained against the ancillary receiver for damages for such tort.[100]

§ 492. **The court appointing a receiver may by a general order permit the receiver to be sued in any court** of competent jurisdiction for liabilities incurred by him in operating the road. While

[96] St. Joseph &c. R. Co. v. Smith 19 Kans. 225.

[97] Blair v. St. Louis &c. R. Co. 25 Fed. 2.

[98] Central Trust Co. v. East Tenn. &c. R. Co. 30 Fed. 895; 30 Am. & Eng. R. Cas. 450; Clyde v. Richmond &c. R. Co. 56 Fed. 539.

[99] Central R. Co. v. Farmers' &c. Co. 113 Fed. 405.

[100] Union Trust Co. v. Atchison &c. R. Co. 87 Fed. 530.

there is safety and convenience to the railroad company and its bondholders in requiring all suits to be brought in the court which appointed the receiver, where justice is administered without the intervention of a jury, it is doubtless a convenience and advantage to claimants to be allowed to seek redress in the local courts of law, where the juries are wont to award the utmost damages against corporations.[101]

§ 493. **The usual course in obtaining leave to sue a receiver is** to file a petition stating the cause of action, and asking leave to prosecute it by suit. Leave to sue should not be granted unless the petition states a *prima facie* cause of action against the receiver; though of course the court should not undertake to decide the case in advance.[102]

493a. **Permission to sue a receiver appointed by a federal court is now given by Act of Congress,** though such suits are subject to the general equity jurisdiction of the appointing court.[103] This act abrogated the rule that a receiver could not be sued without leave of the court appointing him, and gave the unconditional right to bring action in the local courts, and to have the justice and amount of his demands determined by the verdict of a jury. The claimant ceased to be compelled to litigate at a distance, or in any other forum, or according to any other course of justice than he would be entitled to if the property or business were not being administered by a federal court.[104] It is not intended by the words "any act or transaction of his" in the statute to limit the right to sue to cases where the cause of action arose from the conduct of the receiver himself or his agents, but with respect to the question of liability he stands in the place of the corporation.[105] Hence the statute ap-

[101] Dow v. Memphis &c. R. Co. 20 Fed. 260.

[102] Jordan v. Wells, 3 Woods (U. S.) 527.

[103] U. S. Comp. St. 1901, p. 582.

[104] Gableman v. Peoria &c. R. Co. 179 U. S. 335; 21 Sup. Ct. 171; 45 L. Ed. 220; Erb v. Morasch, 177 U. S. 584; 20 Sup. Ct. 819.

[105] Meyer v. Harris, 61 N. J. L. 83; 38 Atl. 690; McNulta v. Lochridge, 141 U. S. 327; 12 Sup. Ct. 11; Texas &c. R. Co. v. Johnson, 151 U. S. 81; 14 Sup. Ct. 250; Stolze v. Milwaukee &c. R. Co. 104 Wis. 47; 80 N. W. 68. For further construction of this statute see Texas &c. R. Co. v. Cox, 145 U. S. 593; 12 Sup. Ct. 905.

plies to a passenger's action for injuries caused by failure to repair a station platform.[106]

Furthermore, the right to sue without resorting to the appointing court, which involves the right to obtain judgment, cannot be assumed to have been rendered practically useless by the provisions in the statute that such suit shall be subject to the general equity jurisdiction of the appointing court so far as the same shall be necessary to the ends of justice.[107] The appointing court has no power to enjoin the bringing of such suits in any other than the federal courts,[108] and a judgment in a suit so brought is conclusive as to the amount.[109]

But a suit instituted by a railway for the purpose of acquiring an easement for a crossing over the railway in the hands of the receiver does not come within the terms of this statute. Such a right, if established, would deprive the company of certain rights and interests, and would tend to diminish the value of the property remaining in the hands of the receiver. The property being in the hands of the court for administration, such court is entitled in the first instance to pass upon the question whether the receiver shall part with any portion of it, and as to whether the compensation for the taking is adequate. Otherwise, the policy of the law in regard to the appointment of receivers would be defeated. The statute authorizes suit to be brought without leave of court only where the suit so instituted is because of some act or transaction of the receiver in carrying on the business connected with the property in his possession.[110]

Since the passage of the federal act allowing suits against receivers without leave of the appointing court, a person who seeks damages for personal injuries by intervening in the receivership suit, cannot afterwards complain that the matter was determined by a master instead of by a jury.[111]

[106] Fullerton v. Fordyce, 121 Mo. 1; 25 S. W. 587.

[107] Texas &c. R. Co. v. Johnson, 151 U. S. 103; 14 Sup. Ct. 250; Pendleton v. Lutz, 78 Miss. 322; 29 So. 164; 51 L. R. A. 649.

[108] Central Trust Co. v. East Tennessee &c. R. Co. 59 Fed. 523.

[109] Garrison v. Texas &c. R. Co. 10 Tex. Civ. App. 136; 30 S. W. 725.

[110] Buckhannon &c. R. Co. v. Davis, 135 Fed. 707; Coster v. Parkersburg &c. R. Co. 131 Fed. 115.

[111] Furrer v. Ferris, 145 U. S. 132; 12 Sup. Ct. 821.

§ 493b. **Under the Texas Statute giving a right of action for injuries resulting in death** caused by the negligence of the proprietor, owner, charterer, or hirer of a railroad, it has been held that a receiver is not a "proprietor, owner, charterer, or hirer" within the meaning of the statute.[112]

§ 494. **The proper remedies against a receiver.**—A receiver in possession of property represents the court, and acts as its representative in the interest of all persons concerned in the property. There can be no interference with his possession except with leave of court. Any person claiming the property, or any interest in it, may present his claim to the court by petition, or may be made a party to the pending suit, and litigate his claim in that; or he may, by leave of court, bring a suit at law for the recovery of the property. The receiver will not be ordered to deliver the property to a claimant until his right is established in one of these modes; and care will always be taken to protect the receiver from personal liability or loss. In accordance with these general principles, one who claims rolling stock in possession of a receiver should try his title to it either by an equitable proceeding by petition, or in the pending suit; or, upon obtaining leave of court, by a suit at law for possession. An action of trover is not an appropriate remedy for trying the question of title, because that is not a suit for the possession, but is an attempt to hold the receiver personally liable for the value of the property. A demand upon the receiver for possession and his refusal to deliver it do not constitute a conversion on his part, and lay the foundation for such a suit.[113] Whether in any case an action of trespass or trover can be maintained against a receiver, when he rightfully takes possession of the property, is questionable. If the property be real estate, so that the title can be tried in an action of trespass without changing such title, or rendering the receiver liable for the value, perhaps there would be no objection to its maintenance. Or, if he has received the rents of real state, or has sold personal property, by order of the court, perhaps the amount in his hands

[112] Turner v. Cross, 83 Tex. 218; 18 S. W. 578; Dillingham v. Scales (Tex.), 24 S. W. 975; Houston &c. R. Co. v. Roberts (Tex.), 19 S. W. 512; Texas &c. R. Co. v. Bledsoe, 2 Tex. Civ. App. 88; 20 S. W. 1135.

[113] Morrill v. Noyes, 56 Me. 458; 96 Am. Dec. 486.

may be claimed in a suit at law. But a claim to cars, engines, or like property in the possession of a receiver, cannot be enforced as a claim for damages.[114]

An original bill against a receiver by a party to the suit in which the receiver was appointed is unnecessary, and a contempt of court. The proper mode of proceeding is by petition in the same cause, or by motion in that cause to obtain leave to prosecute an independent suit either at law or in equity.[115]

§ 495. A statute authorizing suits against receivers does not avail against this rule. The settled rule, that a suit cannot be commenced against a receiver without leave being first obtained from the court appointing such receiver, is not changed, as regards the courts of the United States, by a statute of a state[116] which provides that all receivers appointed by any court, and trustees and assignees running or operating railroad trains in that state, carrying either freight or passengers, may be sued in the several courts of that state in all matters *ex contractu* and *ex delicto* arising after their appointment, without leave of the court appointing or controlling them being first had; and that such suits may be prosecuted to final judgment, and satisfaction may be had out of any property held by them in their fiduciary capacity. No state can pass any law regulating, or in any manner affecting, the jurisdiction and practice of the federal courts.[117]

§ 496. An execution cannot be levied upon property in the hands of a receiver without permission of the court whose officer the receiver is. That court may order the sheriff to withdraw his levy and answer for contempt in making it.[118] If it could be taken

[114] Per Davis, J., in Morrill v. Noyes, 56 Me. 458; 96 Am. Dec. 486.

[115] Payne v. Baxter, 2 Tenn. Ch. 517.

[116] Act of Jan. 6, 1877, of Mississippi. A similar staute of the State of Ohio gives leave to sue a receiver in the courts of that state without leave previously granted. Laws 1872, p. 31, § 1.

[117] Hale v. Duncan, 7 Cent. L. J. 146.

[118] Coe v. Columbus &c. R. Co. 10 Ohio St. 372; Russell v. East Anglian R. Co. 6 Railw. Cases, 501; 3 Mac. & G. 104, 151; Skinner v. Maxwell, 68 N. C. 400; Ellis v. Water Co. 86 Tex. 109; 23 S. W. 858.

piecemeal from the custody of the receiver, the remedy of the creditors under the mortgage would be of little value. The remedy of one who claims that the property was not legally covered by the mortgage, or that, for any reason, it is not legally held by the receiver, is to apply to the court which appointed the receiver to ask its discharge out of custody, in order that he may proceed against it.[119]

The fund in the hands of a receiver cannot be disposed of by the mortgagor to the prejudice of the mortgagee; and the creditors of the mortgagor, having no greater rights in this respect than the mortgagor himself, cannot reach this fund by attachment or trustee process.[120] The possession of the receiver is the possession of the court itself. This rule is applicable not only to property actually in the hands of the receiver, but to that of which he has constructive possession. Any unwarranted interference with the property, either by taking forcible possession of it, or by legal proceedings begun without the sanction of the court appointing the receiver, is a direct and immediate contempt of court, punishable by attachment.[121] The commencement and prosecution of a suit against the receiver by garnishee process, to reach a debt or funds belonging to the company of which he is made receiver, without the sanction of the court appointing him, is such an interference. Such a proceeding is an attempt to deprive the receiver of credits to which he, and he only, is lawfully entitled, and hence is a direct interference with the court in its administration of the estate over which it has appointed its receiver. Even the prosecution of an attachment suit in a foreign state against property of which a receiver might have obtained possession, and the refusal of the plaintiff in such suit to dismiss it by order of the court which appointed the receiver, is a contempt of court,[122] and if the plaintiff is within reach of the court he may be punished.

[119] Robinson v. Atlantic &c. R. Co. 66 Pa. St. 160. See Potts v. Warwick &c. Co., Kay, 142; Bowen v. Brecon R. Co. L. R. 3 Eq. 541.

[120] Newport & Cincinnati Bridge Co. v. Douglass, 12 Bush (Ky.), 673, 709.

[121] Richards v. People, 81 Ill. 551. In this case an attorney, who persisted in a garnishee process against funds which the receiver was entitled to collect, was punished by fine and imprisonment.

[122] Sercomb v. Catlin, 5 Railw. & Corp. L. J. 610; Langford v. Langford, 5 L. J. (N. S.) Ch. 60; Chaf-

If the plaintiff is a corporation, an officer who has the management of its affairs, and who had power to cause the suit to be dismissed, may be punished for the contempt of the corporation.[123]

§ 497. Any wilful interference with a receiver in the possession of the property placed in his charge is a contempt of the authority of the court, and punishable as such;[124] and it matters not whether such interference be under the form of law, as, for instance, when one seizes the property by the process of another court, or whether possession be forcibly taken by a violent mob, as was the case during the railroad riots in the summer of 1877. Accordingly rioters and strikers, who at that time prevented receivers from running trains upon roads under their charge by forcibly seizing the property, were rightly punished by imprisonment for acting in contempt of court.[125] Although the power to punish for contempt is limited to the misbehavior of persons in its presence, or so near as to obstruct the administration of justice, yet the disobedience of or resistance by any person to any lawful writ, process, order, rule, decree, or command of the court, anywhere within the jurisdiction of the court, is treated in as summary a manner as if the contempt were committed in the actual presence of the court. The accused are not entitled as of right to a trial by jury, but the court will proceed in a summary manner to hear the case and order punishment. It will

fee v. Quidneck Co. 18 R. I. 442; Dehon v. Foster, 4 Allen (Mass.), 545; Vermont &c. R. Co. v. Vermont Cent. R. Co. 46 Vt. 792. In Colorado, however, upon a garnishee process against the receiver of a railroad company where the receiver was appointed by a court in another state, it was held not to be incumbent on the court out of which the garnishee process issued to ask leave of the court which appointed the receiver before issuing such process. Phelan v. Ganebin, 5 Colo. 14. A receiver is amenable to a trustee or garnishee process in the absence of statutory provisions exempting him from such process, and when the process does not tend to disturb his rights under the general orders of the appointing court. Phelan v. Ganebin, 5 Colo. 14.

[123] Sercomb v. Catlin, 5 Railw. & Corp. L. J. 610.

[124] Robinson v. Atlantic &c. R. Co. 66 Pa. St. 160; Fripp v. Bridgewater, &c Co. 3 W. R. 356.

[125] Secor v. Toledo &c. R. Co 7 Biss. (U. S.) 513; Doolittle, In re, 23 Fed. 544. The duties of receivers and employees are discussed by Brewer, J., in Frank v. Denver &c. R. Co. 23 Fed. 757.

not, however, take this summary action except in cases free from doubt, and where the overt acts of contempt are clearly and distinctly proved.[126]

§ 498. **Strikers are guilty of contempt of court if, without actual violence, they resort to threats** to induce other employes to abandon the employment, and, by overawing them with preconcerted demonstrations of force, prevent a receiver from operating the road.[127] Where a party of men combine to do an unlawful thing, and, in the prosecution of that unlawful intent, one of them goes a step beyond the others and does an act which the others do not perform, all are responsible for what the one does. It is essential, however, that there should be a concert of action, in an attempt to do some unlawful thing, to make all responsible for the act of one.[128]

§ 499. **There are not wanting instances in which courts, jealous of their power and jurisdiction, have denied the rule** that a receiver is the agent and officer of the court by which he is appointed, and amenable to no other tribunal, and have undertaken to exercise authority over receivers appointed by another court without its consent. Thus, an injunction having been granted by a court of the State of Illinois against the Cairo and Vincennes Railroad Company restraining its agents from using in a particular way a street of the city of Cairo, receivers of the road were subsequently appointed by the Circuit Court of the United States, who entered upon their duties, and apparently used the street in disregard of the injunction. A proceeding for contempt was thereupon instituted in the state court against the receivers without reference to the court appointing them. Upon appeal to the Supreme Court of the state the judgment of the court below, holding the receivers amenable to that court, was affirmed. The decision proceeds upon the ground that receivers are the agents of the corporations whose property they are put in charge of.[129]

[126] King v. Ohio &c. R. Co. 7 Biss. (U. S.) 529.

[127] Higgins, In re, 27 Fed. 443; United States v. Kane, 23 Fed. 748; Doolittle, In re, 23 Fed. 544.

[128] United States v. Kane, 23 Fed. 748.

[129] Safford v. People, 85 Ill. 558, 560; 5 Cent. L. J. 384; 17 Alb. L. J. 209. "The injunction was against

But granting that a court assuming the management of a corporation is bound to respect the limitations imposed upon it by its charter and by the law, the question remains what tribunal shall control the agents of the court, and determine whether they are acting within the limits of the charter and of the law? Upon sound legal principles it has been established that the court appointing the receivers is the only one that can exercise any authority over them. If other courts, without the consent of the court appointing the receivers, were allowed to exercise authority over its agents, this court would in fact submit itself to the control of every other court which might be invoked to sit in judgment upon the acts of receivers. These officers would cease to be the agents of the court that appointed them; and whose agents they would be it might be difficult to determine. The administration of equity through this instrumentality would thus become impossible.

§ 500. The courts of Wisconsin and Iowa have also departed from this doctrine, and held that in all cases where there is no attempt to interfere with the actual possession of the receiver, a suit may be prosecuted against him, in any court of competent jurisdiction, without the permission of the court from which the receiver derived his appointment. In the former state,[130] an action in its courts against a receiver who was operating a railroad under the appointment of the District Court of the United States, for personal injuries occasioned through the negligence of his servants, was maintained without previous leave obtained from the latter court to pros-

the corporation as a legal entity, and its agents, servants, etc. When the receivers were appointed by the federal court, there was no change in the corporate body. Its existence was intact, with its legal functions unimpaired, but simply its acts were performed by agents appointed by the court, and not by the corporation. And the agents appointed by the court to perform its duties and exercise its functions are legally its agents, although they are under the direction of the court appointing them within the limits of its charter. The court only authorizes the receivers to exercise the privileges and perform the duties prescribed by the charter."

[130] Kinney v. Crocker, 18 Wis. 74; Allen v. Central R. Co. 42 Iowa, 683; and see St. Joseph &c. R. Co. v. Smith, 19 Kans. 225; 6 Cent. L. J. 59.

ecute the action. The Supreme Court of the state declared that, although a plaintiff desiring to prosecute a legal claim for damages against a receiver might, in order to relieve himself from liability to have his proceedings arrested under the authority of a court of equity to restrain suits at law under some circumstances, very properly obtain leave to prosecute, yet his failure to do so is no bar to the jurisdiction of the court at law. The court object that, inasmuch as the federal courts have jurisdiction of proceedings against railroads, the result of a requirement that leave should be first obtained to prosecute a suit against a receiver would be to draw into those courts not only the jurisdiction of all actions respecting the title to property in the custody of a receiver, but all actions for the nonperformance of contracts by him, and the state courts would be absolutely divested of jurisdiction unless the federal courts saw fit to grant it.

§ 501. These cases were assailed with much vigor, and their doctrine denied, in a recent case before the Circuit Court of the United States for the District of Iowa. There was an attachment for contempt in commencing a suit in a court of the State of Iowa against a receiver appointed by the United States Circuit Court. Judge Love, after referring to these cases, said:[131] "In my judgment, the doctrine of the Iowa decision contravenes the whole scheme of equity jurisdiction in the matter of appointing receivers, and in the taking of possession, through them, of the property in litigation. The court of equity takes cognizance of a suit against an insolvent company or corporation, and where danger exists that the litigation may prove fruitless to creditors, by waste or a fraudulent disposition of the property, the court will take it into possession by the appointment of a receiver. The property thus becomes a fund subject to the disposition of the court, and under its exclusive control. The principle that the court which has possession and control of a fund has the exclusive right to determine all claims and liens asserted against it, is fundamental. Hence, every court of equity, in such a case, assumes to decide all controversies touching the subject-matter of the suit and the fund; to determine the existence and priority of all liens; to adjust and settle all disputed claims; marshal the assets,

[131] Thompson v. Scott, 22 Int. Rev. Rec. 376, 377; 4 Dill. (U. S.) 508.

and, finally, to distribute the surplus among the general creditors pro rata upon its own principle of equality among creditors. The very ground and reason of this jurisdiction is the inadequacy of mere legal remedies. But, according to the Iowa decision, there is no reason why any party claiming satisfaction out of the fund may not, without the consent of the receiver's court, assert his rights in any competent court, provided he does not attempt to disturb the possession of the receiver; and thus may the decision of the claims and controversies involved in the litigation be withdrawn from the court of equity, where they properly belong, and transferred to the courts of law. And the result would be that claims against the fund would be determined, not by the court having jurisdiction of the case and control of the fund, but by other and different tribunals. . . . The view thus presented applied with redoubled force to railroad foreclosure suits in the United States Circuit Court. The non-resident citizen comes here to set up and enforce the lien of his mortgage, for the very reason that he thinks he would be exposed to injustice in the state courts from local prejudice. But no sooner does he get the railroad property in the hands of a receiver than that officer, if the doctrine of the Iowa court be sound, is exposed to suits in the state courts upon claims and demands of all kinds, and thus the substantial end for which the non-resident complainant comes here is practically defeated. The receiver himself has no beneficial interest in the controversies waged against him in the local courts, and the litigation is practically between the non-resident citizen and the citizen of Iowa. Suits may be brought, and judgments innumerable rendered, against the receiver, all along the line of the railway, by justices of the peace and other local courts. These judgments may, if valid, be made liens upon the railway property, and the federal court must reject them as nullities or recognize and pay them out of the mortgaged property. If the federal courts must recognize and pay them the state courts must recognize and pay them: the state courts thus take from the former court the power of determining, first, what debt shall be paid out of the funds in its hands; second, what claims shall be made liens upon the mortgaged property. Thus would the federal court sit merely to register and pay the judgment and decrees of the state courts."

The soundness of the doctrine set forth in this judgment is be-

yond question, and the position of the state courts to the contrary is wholly indefensible.[132]

§ 501a. **A statute regarding the appointment of agents to accept service of summons** is binding upon a receiver operating a railroad. Such a statute makes it the duty of the receivers to appoint an agent in each county of the state through which the road operated by them runs, upon whom service of process may be had. The reason of this rule is that the obligation to file a written stipulation consenting to service upon their agents is imposed for the protection of citizens of the state.[133]

III. *A Receiver's Liability to Suit for the Negligence of his Employes.*

§ 502. **A receiver is liable in his official capacity for the negligence of his employes** in the same manner and to the same extent that a railway company, operating its road, is liable. The general rule is, that a receiver, in operating the road, exercises the powers and rights of a common carrier, and is, therefore, subject in his representative capacity to all the duties and liabilities of a common carrier;[134] and the earnings of the road in his hands are chargeable with the expenses of operating the road, and damages for injuries to persons or property are included in such expenses.[135]

[132] See, also, Barton v. Barbour, 104 U. S. 126.

[133] Stewart v. Harmon, 98 Fed. 190.

[134] Blumenthal v. Brainerd, 38 Vt. 402; 91 Am. Dec. 349; Paige v. Smith, 99 Mass. 395; Klein v. Jewett, 26 N. J. Eq. 474; Little v. Dusenberry, 46 N. J. L. 614; 50 Am. Dec. 445; Meara v. Holbrook, 20 Ohio St. 137; 5 Am. R. 633; Kinney v. Crocker, 18 Wis. 74, 80; Allen v. Central R. Co. 42 Iowa, 683; Toledo &c. R. Co. v. Beggs, 85 Ill. 80; 28 Am. R. 613; Ohio &c. R. Co. v. Anderson, 10 Ill. App. 313; Sloan v. Central Iowa R. Co. 62 Iowa, 728; 16 N. W. 331; Cowdrey v. Galveston &c. R. Co. 93 U. S. 352; Heath v. Missouri &c. R. Co. 83 Mo. 617; Lyman v. Central Vt. R. Co. 59 Vt. 167; Melendy v. Barbour, 78 Va. 544.

[135] Mobile &c. R. Co. v. Davis, 62 Miss. 271; Kennedy v. Indianapolis &c. R. Co. 2 Flip. (U. S.) 704; Brown, Ex parte, 15 S. C. 518; Kain v. Smith, 80 N. Y. 458, 469; 2 Am. & Eng. R. Cas. 545. In the latter case the court, by Danforth,

Whether the receiver is regarded as the officer of the law, or the representative of the proprietors of the corporation or its creditors, or as combining all these characters, he is intrusted with the powers of the corporation, and must, therefore, necessarily be burdened with its duties, and subject to its liabilities. There can be no such thing as an irresponsible power, exerting force or authority without being subject to duty, under any system of laws framed to do justice. It is an inseparable condition of every grant of power by the state, whether expressed or not, that it shall be properly exercised, and that the grantee shall be liable for injuries resulting directly and exclusively from his negligence in its use.[136] In a recent case in Kentucky, in which, however, the question under consideration was not involved, Mr. Justice Lindsay, upon the functions of a receiver as a common carrier, said: "The receiver of a line of railways is not the mere passive agent or officer of the court, charged with the simple duty of preserving the property intrusted to his care, and of collecting the rents and profits arising directly out of the thing mortgaged, and holding them until the rights of the litigants shall be determined. His duties comprise the management and operation of the roads. He, *ex necessitate*, becomes a common carrier, and, in order to preserve the mortgaged property, is compelled to discharge the duties of a *quasi* public corporation."[137]

Although in some earlier cases in the state courts, the receiver's liability for the negligence of his employes was questioned or denied,[138]

J., say: "Such an officer displaces the directors or other body who by its charter are authorized to manage its affairs, and, under the direction of the court by which he is appointed, has the sole control of its property and effects, and, when authorized so to do, the executive power to use its franchises, and is responsible for his conduct in all these things to the court appointing him."

[136] Klein v. Jewett, 26 N. J. Eq. 474, per Van Fleet, V. C.; Little v. Dusenberry, 46 N. J. L. 614, 638, per Scudder, J.

[137] Douglass v. Cline, 12 Bush (Ky.) 608, 628, per Lindsay, J.

[138] Cardot v. Barney, 63 N. Y. 281; 20 Am. R. 533. In Michigan it is questioned whether a receiver is liable to action in such case. Smith v. Flint &c. R. Co. 46 Mich. 258; 41 Am. R. 161.

Under a statute of the State of Georgia, allowing an employé of a railway company to recover damages against the road for a personal injury done him through the negligence of another employee in the same service, it was held that the employé of a receiver is not an

general considerations of policy have led to the adoption of the rule, that a receiver shall not be allowed to exercise the rights and powers of a common carrier without also being held subject in his representative capacity to a common carrier's duties and liabilities.[139]

§ 502a. A receivership is continuous and is analogous to a corporation sole. An action is not brought against a receiver as a person, but against the receivership. So, a receiver may be sued for the act of his predecessor, under any circumstances where he could be sued for his own act, without special leave of court.[140]

But it has been held that a state law making railroads liable for death caused by their negligence did not apply to a receiver operating the road and consequently neither the receiver nor the company was liable for a death by the neglect of the receiver's employes.[141]

§ 503. A receiver, though empowered by statute to operate a railroad of an insolvent company for the use of the public, is not a public officer, entitled to immunity as such, but may be sued at law in his representative capacity for any negligence of his agents operating the road.[142] "An examination of the cases where this immunity has been given will show that it is limited to those who are strictly public officers, who are parts of the governmental agency of

employé of a railroad company within the terms of that statute, so as to make the receiver liable to action in such case. Henderson v. Walker, 55 Ga. 481; Thurman v. Cherokee R. Co. 56 Ga. 376.

Even if it be regarded as an open question whether the receiver of a railroad, appointed by a court and operating the road under its direction, is liable for injuries done upon the road to person or property, it is regarded as certain that a receiver appointed by the governor of the state, under a law providing for such appointment, is a public agent, and, as such, is not liable for the wrongs or negligence of his employés, but only for his own wrongful acts or delinquencies. Erwin v. Davenport, 9 Heisk (Tenn.), 44; Hopkins v. Connel, 2 Tenn. Ch. 323.

[139] Little v. Dusenberry, 46 N. J. L. 614, 637; 50 Am. R. 445; per Scudder, J.; Brown, Ex parte, 15 S. C. 518, quoting text; Melendy v. Barbour, 78 Va. 544.

[140] State v. Port Royal &c. R. Co. 84 Fed. 67.

[141] Texas &c. R. Co. v. Collins, 84 Tex. 121.

[142] Little v. Dusenberry, 46 N. J. L. 614, 637; 50 Am. R. 445, per Scudder, J.

the state, entirely distinct from individual gain or profit, such as state, county, municipal, and township boards and officers, discharging duties imposed upon them by law, with none behind them but the public, whom they represent, and no funds to answer for damages except those that must be taken from the public treasury. The phrase in the statute, 'to operate said railroad for the use of the public,' does not create this public office. It imposes on the receiver appointed by the chancellor no other duty to the public than that which belongs to every railroad corporation acting under statutory authority."

§ 504. In some states it is no defense at law that the defendant is a receiver acting under the authority of a court of chancery. When, therefore, a suit at law is brought against a person who is in fact a receiver, for loss and damage sustained under his management of a railroad, the court of chancery which appointed him may in its discretion enjoin the prosecution of the suit at law.[143] If, however a receiver desires the protection of the court whose officer he is, he should apply for an injunction; and in case he fails so to do, the action at law may proceed as though permission to bring it had been obtained from such court.[144] He is deemed to have waived, if need be, such ground of objection to the action, or to have voluntarily elected to defend the action at law. The mere fact that the defendant was acting as a receiver under the appointment of a court of chancery is not recognized as a defense to a suit at law for a breach of any obligation or duty which had been assumed by him while acting as such receiver.[145]

[143] Morse v. Brainerd, 41 Vt. 550.

[144] Camp. v. Barney, 4 Hun (N. Y.), 373; Chautauqua Co. Bank v. Risley, 19 N. Y. 369; 75 Am. Dec. 347n; Kain v. Smith, 80 N. Y. 458; Blumenthal v. Brainerd, 38 Vt. 402; 91 Am. Dec. 349; Lyman v. Central Vermont R. Co. 59 Vt. 167; 10 Atl. 346; 30 Am. & Eng. R. Cas. 210; Kinney v. Crocker, 18 Wis. 74.

[145] Blumenthal v. Brainerd, 38 Vt. 402, 408; 91 Am. Dec. 349, per Kellogg, J. "As between a receiver and the parties interested in the trust, the receiver would be responsible for negligence; but he might be liable to other parties in a larger or stricter degree of responsibility. The assumption by the defendants of the peculiar duties and extraordinary responsibilities arising from the relation of common carriers, is not to be considered as necessarily, if at all, incom-

Primarily, any person having possession and control of, and actually operating a railroad, is at law liable as a common carrier for injuries to passengers or freight occasioned by his misconduct or negligence, or that of any of his servants. He is thus the acting, directing, and governing power in operating the road, and is the only tangible principal known to the public. It matters not whether he be a trustee, a lessee, or a mere intruder into the franchise of the corporation.[146] The only exception in favor of a receiver, or distinction between him and any other trustee, is, that he is an officer of the court appointing him, and is under its control and protection.[147]

Receivers in chancery in operating and managing railroads are thus regarded as sustaining to persons dealing with them the character of common carriers. They may at all times invoke the aid of the court appointing them in any matter affecting their duty or liability under their receivership; yet, waiving this, they are amenable in the common law courts to action for negligence as carriers.[148] This liability is extended to losses or damages to property taken charge of by such receivers, although happening after the property has passed over their own road, and while in the charge of other carriers over whose line of road the property was destined and directed.

§ 505. In some states, moreover, a court of law may exer-

patible with any duty or responsibility imposed upon them as receivers. The plaintiff's evidence tended to show that the defendants were managing and controlling a long line of railroad, and conducted and held themselves out as common carriers over that line. If in fact they were common carriers over that line of railroad, we think that it is no defense to an action at law for a breach of a duty or obligation arising out of business intrusted to them in that relation, that they were running and managing the line of railroad as receivers under an appointment of the court of chancery." See, also, Lyman v. Central Vermont R. Co. 59 Vt. 167; 10 Atl. 346; 30 Am. & Eng. R. Cas. 210.

[146] Sprague v. Smith, 29 Vt. 421; 70 Am. Dec. 424; Barter v. Wheeler, 49 N. H. 9; 6 Am. R. 434; Lamphear v. Buckingham, 33 Conn. 237.

[147] Camp v. Barney, 4 Hun (N. Y.), 373.

[148] Newell v. Smith, 49 Vt. 255; Cutts v. Brainerd, 42 Vt. 566; 1 Am. R. 353; Lyman v. Central Vermont R. Co. 59 Vt. 167; 10 Atl. 346; 30 Am. & Eng. R. Cas. 210; Paige v. Smith, 99 Mass. 395; Ballou v. Farnum, 9 Allen (Mass.), 47.

cise jurisdiction in such case without leave being previously obtained from the court of equity which appointed the receiver. This view is well and strongly stated by Mr. Justice Miller in an opinion expressing his dissent from the position taken by the majority of the court:[149] "I know of no principle or precedent," he says, "whereby a court of law having before it a plaintiff with a cause of action of which it has jurisdiction, and a defendant charged with an act also within the jurisdiction, is bound, or is even at liberty, to deny the plaintiff his lawful right to a trial because the defendant is a receiver appointed by some other court, and to leave the suitor to that remedy, when it is known that some of the most important guaranties of the trial to which he is entitled, and which are appropriate to the nature of his case, will be denied him." The defense that the action is one at law against a receiver, and that leave to prosecute it has not been obtained, is one that should not go to the jurisdiction of the common law court; it is one that the receiver can make only by invoking the interference of the chancery court to restrain the prosecution of the suit against him in the common law court.[150]

If the plaintiff is enjoined from prosecuting the suit, and the injunction is afterwards removed, he practically obtains leave to prosecute; and it has been suggested as not improbable that such procedure gave rise to the notion that leave to prosecute is an essential prerequisite.[151]

§ 506. **After judgment has been obtained at law, the fund in the hands of the court whose officer the receiver is cannot be reached without leave of that court,** which may if necessary stay the execution by injunction.[152] If, however, the receiver has conveyed the property to another corporation subject to the payment of all

[149] Barton v. Barbour, 104 U. S. 126.

[150] Lyman v. Central Vt. R. Co. 59 Vt. 167; 10 Atl. 346; 30 Am. & Eng. R. Cas. 210.

[151] Lyman v. Central Vermont R. Co. 59 Vt. 167; 10 Atl. 346; 30 Am. & Eng. R. Cas. 210.

[152] Little v. Dusenberry, 46 N. J. L. 614; 50 Am. R. 445. The same principle applies even after the federal statute authorizing suits at law against receivers. Central Trust Co. v. East Tennessee &c. R. Co. 59 Fed. Rep. 523; Pendleton v. Lutz, 78 Miss. 322; 29 So. 164; 51 L. R. A. 649.

liabilities incurred by him, and a judgment at law has been rendered against the receiver for such injuries, the plaintiff may then file a bill in equity against such purchasing corporation.[153]

But though the claim be one in itself properly cognizable in a court of law, yet if it arises under a contract made by a prior receiver, so that the present receiver could not be sued at law, and the claim is against the trust fund, which is still under the control of the court, jurisdiction of the suit may be entertained in equity.[154]

Where action is brought for a tort committed before the receivership and the receiver is made a party, he is bound by any judgment recovered in the suit, and such judgment should be certified to the court controlling the receivership.[155]

§ 507. The better rule, apart from the enabling statute, is that a receiver, though engaged in the business of a common carrier, cannot be sued without leave of the court of equity which appointed him. The fact that he is acting as a common carrier does not take the case out of the general rule, so that an action at law will lie against him for an injury caused by his negligence, or that of his servants in conducting that business.[156]

[153] Brown v. Wabash R. Co. 96 Ill. 297. Under the code of New York the action in such case might be maintained directly against the purchaser. Schmid v. New York &c. R. Co. 32 Hun (N. Y.), 335.

[154] Kerr v. Little, 39 N. J. Eq. 83. See Palys v. Jewett, 32 N. J. Eq. 302.

[155] San Antonio &c. R. Co. v. Adams, 6 Tex. Civ. App. 102; 24 S. W. 839.

[156] Barton v. Barbour, 104 U. S. 126, 130. "If a passenger on the railroad, who is injured in person or property by the negligence of the servants of the receiver, can, without leave, sue him to recover his damages, then every conductor, engineer, brakeman, or truck-hand can also sue for his wages without leave. To admit such a practice would be to allow the charges and expenses of the administration of a trust property in the hands of a court of equity to be controlled by other courts, at the instance of impatient suitors, without regard to the equities of other claimants, and to permit the trust property to be wasted in the costs of unnecessary litigation." Per Woods, J., who cited Cowdrey v. Galveston &c. R. Co. 93 U. S. 352; Peale v. Phipps, 14 How. (U. S.) 368. See, also, Atlantic &c. R. Co. Ex parte, 4 Hughes (U. S.), 157; Railroad Co. v. Jones, 95 U. S. 439, 443; Melendy v. Barbour, 78 Va. 544.

In Kain v. Smith, 80 N. Y. 458, 469, the court say: "In such case, also, the remedy for injuries re-

So essential is it that the equity court should control the litigation in respect to the property in the hands of its receiver, in order to be able to preserve the property and to distribute its proceeds among those entitled to it according to their equities and priorities, that it has been the common practice for the court in its decree appointing a receiver, to provide that he shall not be liable to suit unless leave is first obtained from the equity court which appointed him.[157]

§ 508. The determination of questions of fact by a court of equity does not impair the constitutional right of trial by jury, though the questions involved in the case are tried according to the usual course and practice in equity. It is a fundamental principle that the right of trial by jury, considered as an absolute right, does not extend to cases of equity jurisdiction.[158]

§ 509. The equity court may in its discretion, where the facts are in dispute, allow the receiver to be sued at law, or may direct the trial of a feigned issue to settle the facts. It may do this of its own motion, or on the prayer of the claimant.

The federal courts in such cases usually require the claimant to come in by petition, and on examination of the proofs taken before a commissioner will themselves determine the question of law, whether the case is one for damages. If it be, the court will order an issue out of chancery, and empanel a jury to assess the damages. The question of negligence is one to be decided by the court.[159]

§ 510. The receiver is entitled to set up any defense to such action that would be available to the corporation itself; such for instance as a statute that requires suits for negligence to be brought against railroads within two years. "The receiver," say the

sulting from his negligence, or the negligence of those operating a railroad under him, would be by application to the same tribunal, which might itself dispose of the matter by administering justice between the parties, or allow the party aggrieved to bring his suit at law for the alleged injury."

[157] Barton v. Barbour, 104 U. S. 126.

[158] Barton v. Barbour, 104 U. S. 126, 130.

[159] Atlantic &c. R. Co. Ex parte, 4 Hughes (U. S.), 157; Railroad Co. v. Jones, 95 U. S. 443.

court, "within the sphere of his functions, represents the company. By virtue of such a relationship he exercises all its necessary franchises; and in my opinion he is its agent, appointed, not by the corporate body itself, but by the law, for certain ends of its own. . . . So far as transacting the business of the road is concerned, the receiver does precisely what the directors, if they had remained in the management, would have been required to do. I am at a loss to see, therefore where the receiver engages employes in such business, why they are not to be regarded as the employes of the company itself. Unless this be so, it is difficult to suggest any principle on which the property of the company in the hands of the receiver is made responsible for the damages resulting from the negligence and misconduct of such employes; and on the other hand, it is the company that receives the benefit of the services."[160]

§ 510a. **A requirement for notice to receivers within six months of the happening of an injury** will not bar an infant for failure to give the required notice, when his rights are not barred by the statute of limitations. Court of equity should be scrupulously considerate of the rights of an infant, however negligent his guardian and relatives and the lawyers they employed may have been in caring for his interests.[161]

§ 510b. **A state "fellow servant act"** has been held to define the liability of a receiver for the negligent acts of his employes causing injury to fellow servants, though the act did not apply in terms to receivers. Such a statute is remedial in its nature and must be construed, if not liberally, certainly in accordance with its obvious purpose and spirit.[162]

§ 511. **A receiver is not personally liable for injuries done through the neglect or misconduct of those employed by him** in the performance of the duties of his office.[163] He is only liable

[160] Bartlett v. Keim, 50 N. J. L. 260; 13 Atl. 7; 3 Railw. & Corp. L. J. 487.

[161] Park v. New York &c. R. Co. 140 Fed. 799.

[162] Mikkelson v. Truesdale, 63 Minn. 137; 65 N. W. 260.

[163] Camp v. Barney, 4 Hun (N. Y.), 373, per Mullen, P. J.; Cardot v. Barney, 63 N. Y. 281; 20 Am. R.

in an action brought against him as receiver, and any judgment recovered must be made payable out of the funds in his hands as receiver. He is not individually the owner of the property in his charge, and he has neither a general nor special property in the road or its earnings. The property is in court for management and administration, and the receiver is an officer of the court obeying its orders and carrying out its directions. It would be a great hardship to impose upon him the hazards and responsibilities which attach to individuals acting by agents appointed for their own convenience and profit. The receiver of a railroad must of necessity operate the road through the employment of agents, and when he has prudently selected his agents he has discharged his full duty, and ought not to be held to guarantee the acts of the agents employed. While there is good reason that one employing another in his business should be responsible for his acts, there is no principle upon which a receiver or other officer of a court should be answerable except for his own neglect and misconduct. Where, therefore, a suit was brought and a judgment entered against a receiver personally, upon appeal the record and proceedings were ordered to be modified so as to make the judgment stand against him as receiver only.[164] But, as will presently be noticed, a judgment against a receiver for damages occasioned through the negligence of his employes cannot be enforced as against the assets in his hands in preference to the claims of mortgage bondholders.[165]

§ 512. Receivers who have wilfully and corruptly exceeded their power are liable for the actual damage sustained by reason of their misconduct, but for nothing more. Where, for instance, they have been authorized to issue certificates of indebtedness payable in ten years at eight per cent. interest, under the restriction that they should not sell them for less than ninety cents on the dollar, and they hypothe-

533; Combs v. Smith, 78 Mo. 32; Little v. Dusenberry, 46 N. J. L. 614; 50 Am. R. 445, per Scudder, J.; Farmers' &c. Co. v. Central R. Co. 2 McCrary (U. S.), 181; Central Trust Co. v. Sloan, 65 Iowa, 655; 22 N. W. 916; Lehigh &c. Co. v. Central R. Co. 29 N. J. Eq. 252; 35 Am. & Eng. R. Cas. 2; Davis v. Duncan, 19 Fed. 477.

[164] Camp v. Barney, 4 Hun (N. Y.), 373, per Mullen, P. J.

[165] See § 514.

cated them for a half or a third of their value, the court held that they were not chargeable in their account for the full value of the certificates so hypothecated, or even with their value at ninety cents on the dollar; for the lenders were bound to take notice of the terms upon which the certificates were authorized, and were bound to return so many of them as were not necessary to secure the amounts advanced. The actual damage sustained by the conduct of the receivers would therefore be merely nominal. If they acted in good faith, but under a mistaken view of their powers, they would perhaps not be liable at all.[166]

§ 513. A receiver is responsible individually for the careful management of property over which he has no control as receiver; that is, property not in the possession of the court, but such as he voluntarily assumed the management of. Thus a receiver operating a road leased to him is liable in a suit at law for injuries resulting from the negligence of his servants in operating the leased road. The leased road is not in such case receivership property. Though the sanction of the court has been obtained by the receiver to his taking the lease, this impresses no character upon him. His character as lessee is not within the scope of his appointment; and the liabilities he assumes are enforcible in the common law courts. The circumstances that would warrant the interference of a court of equity with any proceedings at law to enforce liabilities voluntarily assumed by a receiver in becoming a lessee, would necessarily be of an extraordinary character, if any such circumstances could exist.[167]

The receiver stands, as to the business of the leased road, not as a receiver in the sense that he is in that business an officer of the court, but as a party *sui juris*, acting as his own principal, and upon his own responsibility.[168] He cannot shield himself by setting up his office under the court. His liability in such case is that of an individual.[169]

[166] Stanton v. Alabama &c. R. Co. 2 Woods (U. S.), 506.

[167] Lyman v. Central Vermont R. Co. 59 Vt. 167; 60 Atl. 346; 30 Am. & Eng. R. Cas. 210; Kain v. Smith, 80 N. Y. 458.

[168] Lyman v. Cent. Vermont R. Co. 59 Vt. 167; 60 Atl. 346; 30 Am. & Eng. R. Cas. 210.

[169] Kain v. Smith, 80 N. Y. 458.

§ 514. A judgment for negligence cannot be enforced as against the rights of mortgagees. The appointment of a receiver does not derange the priority of existing liens upon the property, nor in any way impair or postpone them, except so far as the court may find it necessary, for the preservation of the property, to authorize the borrowing of money upon a pledge of it,[170] and except as it may authorize the payment of claims for operating expenses out of the income in the hands of the receiver.[171] Claims or judgments against a receiver for damages to persons or property are not operating expenses. Consequently a person who has recovered a judgment against the receivers of a road, for injuries received by him while travelling upon the road under their management, is not entitled to payment out of the earnings of the road, or out of the proceeds of a sale of it, in preference to the mortgage creditors. "It is too clear for argument," says Judge Woods,[172] "that, if the road had been run by the president and directors when the injury was sustained, no such claim could have priority. The party would have travelled over the road taking the risk of the ability of the company to respond, just as every man who obtains a right or contract does so with the risk of the ability of the party to answer him. The receivers of the court were merely appointed to act instead of the president and directors, except so far as the orders of the court otherwise direct, and the liability stands on the same footing as if it had been created by the president and directors, unless a higher right can be assigned to it under the orders of the court. . . . It is clear that such a lien is not one of the incidents to running a road, nor was its creation necessary to procure traffic and travel; nothing of the kind is intimated in the application for a receiver, and no such view or idea is presented in the order. . . . The exercise of power by a court to displace liens can only be sustained on the ground of actual necessity, and surely there can be no necessity to append, as an incident to running a railroad, a lien for damages that displaces existing contracts. The party has a right to be allowed his claim, to be paid from an excess remaining. He has the same right against the property

[170] Norway v. Rowe, 19 Ves. Jun. 144, 153, per Lord Eldon.

[171] See § 603.

[172] Davenport v. Alabama &c. R. Co. 2 Woods (U. S.), 519, 520. See, however, Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 527.

which he could have had if the road had been run by the president and directors when his right accrued, and none other."

§ 515. A receiver is not liable for anything occurring after his title and possession have been duly terminated. Thus in an action by a passenger for the loss of a trunk by fire against receivers of a railway in whose possession it is alleged the trunk was at the time, it is competent for the receivers to show that, prior to the actual loss, the receivers' powers and possession had been terminated, and the property by order of court conveyed to others, although they were in possession of the railroad when the trunk was delivered to them.[173]

The same rule applies in case of a suit against a receiver to recover damages for personal injuries incurred while the road was under the management of the receiver. If the suit be commenced after his discharge he is not liable in his official capacity, but only in case he was personally at fault.[174] After the discharge of a receiver, unsettled claims against him may be prosecuted as proceedings *in rem*, whether the claims be upon contract or tort, provided they be such as would, if established, constitute liens upon the property. If the property has passed into the hands of a purchaser subject to such liabilities incurred in the management of the property by the receivers as might afterwards be established, the court may establish a lien against the property in the hands of the receiver, and in default of payment may order the property to be sold to satisfy the lien.[175] One who has purchased under an order of court, subject to the liabilities created by a receiver, cannot be permitted, after accepting the property, to question the validity of the order, or its authority to enforce the payment of such liabilities.[176]

§ 516. The discharge of a receiver operates as a discharge of the property for torts committed before the discharge, and the

[173] Corser v. Russell, 20 Abb. N. C. (N. Y.) 316, 319. "It may be that receivers who continue after the order deposing them, and until their successors are sworn in, can be held responsible for acts done ad interim, but his case presents no such element." Per Brady, J

[174] Ryans v. Hays, 62 Tex. 42.

[175] Farmers' &c. Co. v. Central R. Co. 2 McCrary (U. S.), 181; 7 Fed. 537.

[176] Farmers' &c. Co. v. Central R. Co. 5 McCrary (U. S.), 421.

court cannot, after the adjournment of the term at which the order was made and entered, in any way alter, change modify, or expand the decree discharging the receiver, and again obtain jurisdiction over the property and funds which it had by its decree ordered the receiver to turn over to the corporation.[177] In a case where a receiver had possession of property of another, and with knowledge of his claim, sold the property, it was held that his discharge did not operate as a discharge of the property held by him, especially in case the claimant had no notice of the receiver's application for a discharge.[178]

But the fact that before a hearing in intervention proceeding, a sale of the railroad property is made does not change the nature of the proceedings further than to make it necessary that the purchaser is made a party to the intervention. It is still a proceeding in the matter of the receivership in the foreclosure suit, as much as if the railroad at the time of the hearing, was still in the hands of the receiver. It would be an abuse of power by the court to require or permit expensive litigation as to claims the amount of which are readily ascertainable.[179]

IV. *The Company itself is not liable after the Receiver has assumed Control.*

§ 517. The railroad company itself, whose property is in the hands of a receiver, is not ordinarily liable for injuries received through the acts of persons under his control, or through the running of the road under his charge.[180] His acts are not the acts of

[177] Davis v. Duncan, 19 Fed. 477.

[178] Miller v. Loeb, 64 Barb. (N. Y.) 454.

[179] Central Trust Co. v. Denver &c. R. Co. 97 Fed. 239.

[180] Bell v. Indianapolis &c. R. Co. 53 Ind. 57; Ohio &c. R. Co. v. Davis, 23 Ind. 553; 85 Am. Dec. 477; Memphis &c. R. Co. v. Stringfellow, 44 Ark. 322; 51 Am. R. 598n; Kansas Pac. R. Co. v. Searle, 11 Colo. 1; 16 Pac. 328; Ohio &c. R. Co. v. Anderson, 10 Ill. App. 313; Wyatt v. Ohio &c. R. Co. 10 Ill. App. 289; Leathers v. Shipbuilders' Bank, 40 Me. 386; Heath v. Missouri &c. R. Co. 83 Mo. 617; Turner v. Hannibal &c. R. Co. 74 Mo. 602; Davis v. Duncan, 19 Fed. 477; Ryan v. Hays, 62 Tex. 42; International &c. R. Co. v. Ormond, 62 Tex. 274; Railroad Co. v. Hoechner,

the corporation, nor is his possession the possession of the corporation. He is under the control of the court that appointed him, and his possession is the possession of the court. It would be a severe rule, and one founded on no principle, that would render the railroad company responsible for the negligence of the agent of the court that had deprived it of the posssession of the road. To an action against the company, it is sufficient to answer that at the time the injuries were inflicted on the plaintiff the railroad, with the rolling stock and all the company's property, was in the actual control of a receiver duly appointed. It is not necessary that the answer should set forth a copy of the order appointing the receiver.[181] The corporation itself cannot be held liable for goods lost or not delivered under a contract made with receivers for their transportation and safe delivery, the road being in the hands of receivers. The action only lies against the receivers, and no personal judgment can be rendered against them, but only one against them in their official capacity.[182]

The court, may however, permit a suit against a company in the hands of a receiver to be prosecuted to final judgment, for the purpose of fixing the rights of the parties.[183]

The company is not liable to criminal prosecution for acts committed by agents and servants of the receiver, while he is in full possession of the road, and has entire charge of its affairs.[184]

§ 518. But unless the possession of the receiver under a decree of court is exclusive, and the servants of the road are wholly employed and controlled by him, the company is not relieved from liability for injuries done by the servants employed in working the road. Where, for instance, a road is run on the joint account of a receiver of part of it, and of a lessee of the remaining part, the company, as well as the lessee, is liable for injuries committed by a

67 Fed. 456; 14 C. C. A. 469; Chamberlain v. New York &c. R. Co. 71 Fed. 636; Lock v. Turnpike Co. 100 Tenn. 163; 47 S. W. 133.

[181] Bell v. Indianapolis &c. R. Co. 53 Ind. 57.

[182] Ellis v. Indianapolis &c. R. Co. 6 Am. Law Rec. 288.

[183] Wyatt v. Ohio &c. R. Co. 10 Ill. App. 289; Heath v. Missouri &c. R. Co. 83 Mo. 617.

[184] State v. Wabash R. Co. 115 Ind. 466; 17 N. E. 909; 35 Am. & Eng. Corp. Cas. 1.

servant employed upon the road upon a passenger, in improperly expelling him from a car, especially where the company has allowed tickets to be issued in its own name, in the same form as it has done before the road was leased, and the passenger apparently having no reason to know that the road was not still under the company's management.[185]

It is not necessary, of course, to obtain authority from the court which has appointed a receiver of a railroad to commence an action against the company itself. Nor is such consent necessary to continuing a suit commenced against a railroad company before the appointment of the receiver. Such appointment has not the effect to abate, bar, or continue an existing suit against the company. The receiver may interpose, however, when the plaintiff undertakes to interfere with the property by enforcing an execution.[186]

§ 519. In determining the question whether the corporation is liable for injuries done after the appointment of a receiver, it is important to inquire whether the receiver has at the time of the injury entered upon the discharge of his duties and assumed control of the road. Thus a receiver of the Central Railroad of Iowa was appointed by the Circuit Court of the United States on the seventh day of January, 1875, and he was allowed fifteen days within which to give bonds. In a suit against the company for an injury which occurred to a passenger on the eighteenth day of the same month, there was no proof that the receiver had at that time assumed control of the road. Upon the contrary, there was some testimony tending to show that the defendant company was operating the road at that time. At any rate the Supreme Court of Iowa did not consider the question, whether a railroad company could be made liable for damages resulting from the improper management of the road while in the hands of a receiver, involved in the record of the case.[187]

§ 520. When suit allowed against company for receiver's acts.—

[185] Railroad Co. v. Brown, 17 Wall. 445; Pennsylvania R. Co. v. Jones, 155 U. S. 333; 15 Sup. Ct. 136.

[186] Toledo &c. R. Co. v. Beggs, 85 Ill. 80; 28 Am. R. 613; Ohio &c. R. Co. v. Nickless, 71 Ind. 271; Wyatt v. Ohio &c. R. Co. 10 Ill. App. 289.

[187] Allen v. Central R. Co. 42 Iowa, 683; 9 Am. St. 518.

If an action at law is brought against a railroad company to recover for injuries incurred while the road was in the hands of a receiver, and the plaintiff is allowed to amend by substituting the receiver as defendant, the equity court, whose officer the receiver is, in granting permission to proceed against the receiver, may restrain him from setting up in defense the statute of limitations, the action having been commenced against the company within the statutory time. The action against the receiver is not in such case a new action.[188]

If, after a claim for damages on account of personal injuries has arisen against a receiver, he by direction of the court turns over the railroad to the company that made the mortgage, upon condition that it assumes and pays all liabilities incurred while the road was operated by the receiver, and the property is accepted on this condition, the company becomes liable and subject to action directly to the person injured.[189] Furthermore a court may take judicial notice of such an order for liability of the company for injury caused while the receiver is in charge, when the claimant intervenes in the original receivership suit to enforce his claim for damages.[190] Where a receiver diverts earnings to permanent betterments of which the railroad has the benefit, an action at law on a tort claim against the receiver may be maintained against the company, and a personal judgment may be rendered against it thereon.[191]

If a receiver has unlawfully appropriated land of a citizen to the use of the corporation, and after the discharge of the receiver the corporation resumes control of the road and retains possession of the land, the owner may recover possession of the land, or may maintain an action against the corporation for damages.[192]

§ 520a. Recognized exceptions to the rule that a railway company is not responsible for the acts of a receiver are cases where the order appointing the receiver is void; cases of enforcement of equitable liens arising from the diversion of net earnings and cases where

[188] Lehigh &c. Co. v Central R. Co. 29 N. J. Eq. 252; 35 Am. & Eng. R. Cas. 2.

[189] Sloan v. Cent. Iowa R. Co. 62 Iowa, 728; 16 N. W. 331; and see Farmers' &c. Co. v. Central R. Co. 2 McCrary (U. S.) 181.

[190] Baltimore &c. R. Co. v. Burris, 111 Fed. 882.

[191] Texas &c. R. Co. v. Bloom, 60 Fed. 979.

[192] Bloomfield R. Co. v. Van Slike, 107 Ind. 480; 8 N. E. 269.

by order of the court making the sale, claims are given a lien on the *corpus* of the property in the hands of the purchaser.[193] In the view of the Texas Court a railway company may be held directly liable when a receiver is appointed in an amicable suit at the instigation of the company and for the company's own purposes, and, these purposes being accomplished, the property is returned to the owner, the rights of no third persons as purchasers intervening, upon the ground that the acts of the receivers may well be regarded as the acts of its own servants, rather than those of an officer of the court, which under such circumstances he could only be *sub modo*. This has been declared to be a question of general law and for the state court to pass upon.[194] The conduct of a railway company in acquiescing in the withdrawal of a receivership and in the discharge of the receiver, and in accepting the restoration of its road affords grounds to charge an assumption of such valid claims against the receiver as were not satisfied by him. The appointing court has no power or authority to require persons having claims against receivers or against the company to intervene in the receivership suit within a limited time or forfeit their right.[195]

This doctrine of liability for acts of the receivers does not apply, even in Texas, where there is a sale of the road under a decree of court.[196]

§ 521. Liability of company as affected by statute.—Under a statute making receivers or other persons running or controlling any railroad in the corporate name of the company liable jointly or severally with such company, for stock killed or injured by the locomotive, cars, or other carriages of such company, an action may be brought against the company alone for such acts done while a receiver is in possession. The appointment of a receiver does not destroy the

[193] Missouri &c. R. Co. v. McFadden Bros. 89 Tex. 138; 33 S. W. 853.

[194] Texas &c. R. Co. v. Johnson, 151 U. S. 81; 14 Sup. Ct. 250; Texas &c. R. Co. v. Comstock, 83 Tex. 537; 18 S. W. 946; Texas &c. R. Co. v. Gaal, 14 Tex. Civ. App. 459; 37 S. W. 462; Texas &c. R. Co. v. White, 82 Tex. 543; 18 S. W. 478. See also San Antonio &c. R. Co. v. Flato, 13 Tex. Civ. App. 214; 35 S. W. 859.

[195] Texas &c. R. Co. v. Bloom, 164 U. S. 636; 17 Sup. Ct. 216; Missouri &c. R. Co. v. Chilton, 7 Tex. Civ. App. 183; 27 S. W. 272.

[196] Dillingham v. Kelly, 8 Tex. Civ. App. 113; 27 S. W. 806.

corporate existence. Its corporate powers and franchises are for the time being, so far as necessary for the operating of the road, conferred upon the receiver, but the corporate existence is left intact. Suits may be prosecuted against the corporation after the decree appointing a receiver, just as well as before.[197]

Where negligence on the part of those operating the road is not an element that is at all essential to a recovery, as for instance where a statute makes a railroad liable for cattle killed upon its track in case this is not fenced, a railroad company has been held liable for stock thus killed, although the road is at the time operated by a receiver duly appointed by a competent court. Such a statute is regarded as in the nature of a police regulation, designed to promote the security of persons and property passing upon the road; and not only the terms of the law, but the reason of it as well, are regarded as applicable to roads operated by a receiver, equally with those operated by the servants of the company.[198] The company is liable under a statute which fixes an absolute liability upon the company for such injuries, though the statute does not expressly provide that the fact that the company's road is in the possession of a receiver shall not limit or restrict the company's liability.[199]

A statute requiring a railway company within a certain time to fence its right of way, is a police regulation, and its operation is not arrested by the appointment of a receiver. The receiver has only a temporary management of its affairs under the direction of the court. The corporation still exists, and may exercise any of its functions, so long as it does not disturb the possession of the receiver. There is nothing to prevent its building a fence as required by statute, and the fact of the receivership is no defense to an action by an adjacent owner to recover under the statute twice the value of a fence built by him.[200]

[197] Louisville &c. R. Co. v. Cauble, 46 Ind. 277; Indianapolis &c. R. Co. v. Ray, 51 Ind. 269; People v. Barnett, 91 Ill. 422; Kansas &c. R. Co. v. Wood, 24 Kans. 619; Ohio &c. R. Co. v. Russell, 115 Ill. 52; 3 N. E. 561; Williams ex parte, 17 S. C. 396.

[198] McKinney v. Ohio &c. R. Co. 22 Ind. 99; Ohio &c. R. Co. v. Fitch, 20 Ind. 498.

[199] Kansas &c. R. Co. v. Wood, 24 Kans. 619; Kansas City &c. R. Co. v. Ewing, 23 Kans. 273.

[200] Ohio &c. R. Co. v. Russell, 115 Ill. 52; 3 N. E. 561.

§ 522. **A special receiver or assignee of the property of a railroad corporation, appointed in bankruptcy proceedings, involuntary on its part, is not an agent or servant of the corporation,** and therefore the corporation is not liable for damages occasioned by his negligence and that of persons employed by him in operating the road. In a suit against the Buffalo, Corry and Pittsburgh Railroad Company, it appeared that the accident, which was the occasion of the suit, occurred after the date of a sale made under an order of court by the receiver or assignee, but before the confirmation of the sale and delivery of the deed to the purchasers. It was contended in behalf of the plaintiff that the property and franchises and legal entity of the corporation had, at the time of the accident, passed to the purchasers, who thereby became the corporators constituting the corporation, taking the place of the former stockholders; and that, although the sale was not then confirmed, the deed, when given, related back to the time of the purchase. The Court of Appeals of New York replied that, conceding this to be so, it did not follow that the purchasers were responsible for the negligence in operating the road, inasmuch as they then had no right to intermeddle with the road, and had not in fact done so.[201] The persons operating the road were not employed by them, nor were they subject in any respect to their control. Neither had the purchasers taken the place of the preexisting stockholders, becoming its corporators, and acquiring the corporate entity, although they acquired the property and the franchise of using it subject to the public obligations which had rested upon the defendant corporation. The statute authorizing purchasers under a foreclosure sale[202] to organize a new corporation does not make them stockholders in the existing corporation: were this so, the property purchased would be liable to all the existing debts of the corporation, and both the mortgage security and the rights of the purchasers might thus be entirely defeated.

Moreover, the defendant corporation in this case had been deprived, by the act of law, of the possession of the road and of all control

[201] Metz v. Buffalo &c. R. Co. 58 N. Y. 61; 17 Am. R. 201; and see, to same effect, as to liability of purchasers, Commonwealth v. Central Passenger R. Co. 52 Pa. St. 506; Wellsborough &c. Co. v. Griffin, 57 Pa. St. 417.

[202] Laws 1857, ch. 444.

over those engaged in operating it; and by like act, the possession and control had been given to others. The defendant had nothing to do with operating the road. The fact that the profits earned became assets for the payment of the debts of the corporation did not make it liable for the conduct of those who were in no sense its employes or servants.

§ 522a. **Where a tort claim arises after a sale on foreclosure but before confirmation,** the road being still operated by a receiver, and the foreclosure decree charges the purchaser with all outstanding debts and obligations, the receiver and purchaser are both proper parties defendant to an action for damages brought after the discharge of the receiver, but within the time limited for bringing such actions.[203]

V. *Discharge and Removal of Receiver.*

§ 523. **A receiver will be discharged when it appears that the security of the creditor no longer requires his continuance.** Upon the application of the Milwaukee and Minnesota Railroad Company for the discharge of a receiver of a portion of its line extending from Milwaukee to Portage, it appeared that this section of ninety-five miles constituted a link in an important route, which was in good condition, and whose gross annual earnings were $800,000; that the whole mortgage debt upon this was $2,200,000, upon which the interest was wholly paid; and the company proposed, on receiving possession, to pay to the second mortgagees, at whose instance the receiver was appointed, $300,000 or more. Judge Miller, sitting in the Circuit Court, was of opinion that there was no reason why the receiver should longer retain control of the property, especially as the decree in favor of the mortgagee would stand as security for his further claim, on which he could have an order of sale for any instalment of interest.[204]

In the same case a judgment creditor whose claim was less than

[203] Denver &c. R. Co. v. Gunning, 33 Colo. 280; 80 Pac. 727.

[204] Howard v. La Crosse &c. R. Co. 1 Woolw. (U. S.) 49. See, also, Long Branch &c. R. Co. in re, 24 N. J. Eq. 398.

twenty thousand dollars objected to the discharge of the receiver; but the judge did not consider the objection valid in view of the fact that this creditor had all the ordinary remedies for enforcing his lien, and had received only one thousand dollars for four years, during which the receiver had been in possession.

A lessee of a railroad holding the lease as security for a large debt, from which the possession was taken by a receiver appointed at the instance of a mortgagee, upon the discharge of the receiver is entitled to have possession restored to him. But a creditor holding such lease, who has failed to pay the sums which he stipulated to pay, and who has lost possession by reason of such failure, and has permitted the property to remain out of his possession for four years, is not entitled to have the possession restored to him.[205]

After the appointment of a receiver, upon the subsequent payment of a part of the debt, the security being ample for the balance of the debt, and the decree being allowed to stand as a means of enforcing the mortgage upon a subsequent default, the receiver was discharged.[206]

In New York it is provided by statute[207] that neither the sale of the mortgaged property under foreclosure, nor the formation of a new corporation by the purchaser, shall interfere with the authority or possession of any receiver of the property and franchises aforesaid, but he shall remain liable to be removed or discharged at such time as the court may deem proper.

When a foreclosure suit in which a receiver has been appointed is abandoned or discontinued, the owner of the equity of redemption, from whom the possession was taken, is entitled to claim and receive the possession again. The discontinuance of the suit, so far as regards the intercepting of the rents and profits is concerned, puts the parties in the same position as they were before the suit was instituted and a receiver appointed.[208]

§ 524. The discharge of a receiver, like his appointment, is ordinarily a matter resting wholly within the discretion of the court

[205] Howard v. La Crosse &c. R. Co. 1 Woolw. (U. S.) 49.

[206] Souter v. La Crosse &c. R. Co. 1 Woolw. (U. S.) 49.

[207] Laws 1876, ch. 446, p. 482.

[208] Johnston v. Riddle, 70 Ala. 219.

from which he received his appointment, and of course no appeal ordinarily lies from the order to the appellate court.[209] But this is not always and absolutely so. Thus, while the parties to a foreclosure suit are litigating the amount of the mortgage debt, the appointment of a receiver of the property, and his discharge as well, belong properly to the discretion of the court in which the litigation is pending. But when the amount due has been passed upon by that court, and upon appeal has been finally fixed by the appellate court, the right of the mortgagor to pay that sum, and have a restoration of his property by a discharge of the receiver, is clear, and does not depend upon the discretion of the court. It is a right which the party can claim; and a refusal of the court to grant it is a judicial error which the appellate court is bound to correct, when the whole case is fairly before it.[210]

§ 525. After a receiver has been discharged from his office, the court that appointed him has no power to proceed summarily against him to compel him to pay claims from funds received by him or in his hands. He is no longer subject to the jurisdiction of the court, except as such jurisdiction is acquired in the ordinary methods available to all suitors. In a proper case, to prevent hardship and afford relief which could not be had by an ordinary suit because the claim would be discharged by the statute of limitations, the court might vacate the order discharging the receiver, and thus reinstate the petitioner to the position occupied prior to his discharge.[211] Where a receiver has been discharged pending an action against him, a judgment afterwards rendered in the action would not be effectual, because it would neither bind the funds nor bind the receiver individually.[212]

A state act providing that the discharge of a receiver shall not abate any pending suit on a cause of action accruing against a re-

[209] Washington City &c. R. Co. v. South Maryland R. Co. 55 Md. 153.

[210] Milwaukee &c. R. Co. v. Soutter, 2 Wall. (U. S.) 510.

[211] New York &c. Co. in re v. Jewett, 43 Hun (N. Y.) 565.

[212] Woodruff v. Jewett, 37 Hun (N. Y.) 205. There must be a formal discharge or an actual winding up of the receivership business to release the receivers. Fordyce v Chancy, 2 Tex. Civ. App. 24; 21 S. W. 181.

ceiver as such does not apply to judgments of federal courts discharging receivers appointed by them.[213]

§ 526. Upon a motion to vacate an order previously made appointing a receiver he should not be heard in opposition, as he has no standing in court for such purpose. It is not within his province to intermeddle in questions affecting the rights of the parties in interest, or the disposition of the property in his hands, except so far as his own rights are concerned in the adjustment of his accounts. Where, therefore, all the parties in interest concurred in the vacating of the receivership, but the court, upon the objection of the receiver himself, while ordering the restoration of the railroad and its appurtenances to the company, required him still to receive and disburse its earnings and income, the order upon appeal was judged erroneous. The motion should have been granted so as to fully restore the possession, management, and control of the road to the owner, including, of course, the receipt and disbursement of its earnings.[214]

§ 527. The rescission of an order appointing a receiver after the commencement of an action of replevin or possessory warrant against him for an engine, or other property, does not free him from liability upon a judgment against him, although he has surrendered the property to the railroad company of which he had been receiver; for when the suit was commenced he was in possession of the engine as the receiver of the company, and the plaintiff's rights against him were fixed as of that time. When he voluntarily turned over the engine to the possession of the company while the suit was pending against him for the possession of it, he did so at his own peril. The company could not have compelled him to surrender it until the plaintiff's claim to the possession of it had been decided.[215]

§ 528. Specific complaints against a receiver of maladministration of his trust will receive the attention of the court, although

[213] Fordyce v. Beecher, 2 Tex. Civ. App. 29; 21 S. W. 179.

[214] L'Engle v. Florida Cent. R. Co. 14 Fla. 266.

[215] Peacock v. Pittsburgh Locomotive & Car Works, 52 Ga. 417.

brought to its notice in an irregular way, as, for instance, by a petition under an order for leave to answer in the name of the receiver in a foreclosure suit.[216]

The power to vacate the appointment of a receiver is implied in the power to appoint.[217] Like the power of appointing a receiver, the power to remove him rests in the discretion of the court; but this power should be exercised only for cause grounded in some consideration of justice or convenience. "It might be difficult," said Van Fleet, V. C., in a case before the Court of Chancery of New Jersey,[218] "if not impossible, to say what will be esteemed sufficient cause in every imaginable case; but it may be said generally, if the receiver was an officer of the corporation at the time it became insolvent, and it appears proper that his conduct, as such officer, should be investigated, to see whether he has not obtained a benefit or advantage, which in equity he ought not to be permitted to retain, sufficient cause for his removal exists."

Upon complaint by the employes of a railroad receiver in respect to a reduction of their wages, the court will not interfere to reverse the receiver's adminstration by settling the details of the complaints, involving an extensive investigation; but if an abuse of administration is made manifest, will select a new receiver, to whom such matters may be intrusted.[219]

§ 529. **It is ground for the removal of two receivers of a railroad that they have become hostile to each other** in the management of the road. Two receivers of the Kansas Pacific Railway, who had been appointed at the instance of the parties in interest for the purpose of representing the opposing views of the parties, having disagreed about the management of the road, were for this, in connection with other reasons, removed.[220] Among the other reasons given by the court were, that the receivers had established separate places of business a thousand miles apart, and that neither of them was

[216] Coe v. New Jersey &c. R. Co. 28 N. J. Eq. 31; 14 Am. Railw. R. 9.

[217] Cincinnati &c. R. Co. v. Sloan, 31 Ohio St. 1; Hale v. Nashua &c. R. 60 N. H. 333.

[218] McCullough v. Merchants' &c. Co. 29 N. J. Eq. 217, 218.

[219] Continental Trust Co. v. Toledo &c. R. Co. 59 Fed. 514.

[220] Meier v. Kansas &c. R. 5 Dill. (U. S.) 476; 11 Chic. L. N. 41; 6 Reporter, 642; 4 Dill. (U. S.) 378; Wood v. Oregon Development Co. 55 Fed. 901.

within two hundred miles of the road whose operations they controlled. "There is no necessity," said Mr. Justice Miller, "and a manifest impropriety, in having a receiver located in New York. It is true many such Western corporations as this have officers in New York, at which most of the financial business of the companies is transacted; but this has always been felt to be a grievance by the people of the West, whose business the road does, and by the income of which it can live; and where such a company comes under the control of a court by reason of its insolvency, and a receiver is appointed to take charge of it, such control as the court can exercise over the operations of the road, and in collecting and disbursing its receipts, can be most safely and wisely exercised, and more strictly, under the eye of the court, by an officer residing within its jurisdiction. I think, therefore, on general principles, and on the facts of this case, there was no necessity for a receiver in the city of New York. I am of the opinion that the receivership in New York should be abolished in the interest of economy. Its expenses are unnecessary, and, as administered, excessive."

But the controlling consideration with the court in this case was that the receivers had become antagonistic, so that they represented two hostile camps, each bent upon securing the whole or the larger share of the spoils. It therefore became the duty of the court to see that its powers are exercised on principles of strict neutrality as regards the belligerents, and this could only be done by removing the representatives of the hostile interests, and appointing an impartial receiver in their place.

§ 530. **The court will remove receivers who abuse their trust by using it to advance their own interests** in other corporations, although they have the support of a majority in interest of the mortgage bondholders. The majority of the bondholders very likely may support the doings of the receivers, because they also are interested in the same corporations. The court will not retain as its officers receivers who are scheming to benefit a portion of the bondholders, though this portion be the majority, by taking the earnings of the road to pay unjust claims of other corporations in which the majority are more interested, or by using their powers in any way to injure the railroad they should protect, or to deprive a portion of the

bondholders, though only a minority, of the equal rights secured to all the bondholders.[221]

VI. *Compensation and Account of Receiver.*

§ 531. The question of the compensation to be allowed a receiver is one that properly belongs to the master to whom his accounts are referred, and not to the court; but, of course, is determined by the court when its decision is desired or rendered necessary. Want of foresight in the receiver of a railroad in regard to the future developments of business is no reason for denying him compensation, or reducing the amount of it, when the trust has been administered with reasonable success, and with integrity and good faith.[222]

When the accounts of a receiver have been referred to a master for examination and report, no exceptions to the report will be considered by the court unless they have first been made before the master.[223] This is required in justice both to the master and to the receiver. To the master, that he may have an opportunity to reconsider his decision; to the receiver, that he may sustain his account, if he can, by additional evidence, or make such explanation as the case may require. This rule would not deter the court from directing an account to be reformed, which contains manifest errors or plainly improper charges; but such errors or improper charges ought to be clearly shown to exist, and their character as such ought to be evinced by the proofs in the case, or by their intrinsic nature.[224] A receiver's report, which has been passed by a master, is only assailable by a direct proceeding in court alleging error, fraud, mistake or the like.[225]

The books, contracts, and accounts of a receiver relating to the receivership are in the custody of the law. He is a trustee for the

[221] Atkins v. Wabash &c. R. Co. 29 Fed. 161.

[222] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331; affirmed 93 U. S. 352.

[223] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331; affirmed 93 U. S. 352.

[224] Per Mr. Justice Bradley, in Cowdrey v. Railroad Co. 1 Woods (U. S.) 331.

[225] Farmers' &c. Co. v. Central R. Co. 1 McCrary (U. S.) 352.

parties interested in the subject-matter of the trust, and bondholders, stockholders, or creditors are entitled upon reasonable application to an inspection of the books and accounts.[226]

A receiver should be charged with interest on any moneys belonging to the trust which he has used or deposited in his own private bank account.[227]

A receiver is as much an officer of court as a master is, and when under an order of court he states his own account, and submits it to the master, the latter acts in place of the court in a judicial rather than a ministerial capacity. Strictly speaking, exceptions to his report in such cases do not properly lie, as they do to an account stated by himself, as, for instance, when he states the account of trustees or partners. Nevertheless, if the master adopt any erroneous principle in allowing a receiver's account, the court, on petition of the proper parties, will refer the matter back to him for correction. The duty of the court, therefore, consists in reviewing the principles and rules adopted and followed by the master in allowing the receiver's accounts, rather than in examining the items of the account in detail, or the evidence on which those items are severally founded,—the latter duty belonging more especially to the province of the master acting in his judicial capacity, analogous to the province and duty of a jury on questions of fact.[228]

§ 532. The amount of compensation allowed to a receiver is graduated somewhat by his duties, and somewhat by the responsibilities of the situation.[229] In general, the compensation of a receiver should be regulated by analogy, as nearly as possible, to the rate of commissions allowed to trustees for the performance of kindred services.[230] In ordinary receiverships of moderate amount, five per cent. on the receipts and disbursements has been allowed; but where the amounts received and disbursed are large, as is usually the case

[226] Fowler's Petition, 9 Abb. N. C. (N. Y.) 268; Lafayette Co. v. Neely, 21 Fed. 738.

[227] Hinckley v. Railroad Co. 100 U. S. 153.

[228] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331, per Bradley, J.

[229] Bank Comm'rs v. Franklin Inst. for Savings, 11 R. I. 557; McArthur v. Montclair R. Co. 27 N. J. Eq. 77; Jones v. Keen, 115 Mass. 170; Corey v. Long, 12 Abb. Pr. N. S. (N. Y.) 427.

[230] Tome v. King, 64 Md. 166; 21 Atl. 279.

where the property is a railroad, it is not the practice to allow a percentage, but to fix the compensation in some other manner. The receiver of a railroad is a manager as well as a receiver; and the business of a railroad is one of the most difficult and responsible duties that a receiver is charged with. The peculiar duties, responsibilities, and accountability of a receiver entitle him to a larger amount than would be demanded by the president or head officer of the same railroad. In the matter of the receivership of the Galveston Railroad Company, Mr. Justice Bradley allowed the receiver the sum of ten thousand dollars per annum in coin, although the previous salaries given to the president of the road had not exceeded half that sum.[231]

In another case the Circuit Court of the United States allowed ten thousand dollars for nearly two years' services. The Supreme Court of the United States being called upon by the receiver to review the allowance and increase it, that court declined to do so, saying that the allowance must be remitted largely to the discretion of the circuit court.[232] In the case of the receivership of the Wabash Railroad, which was one of great importance and responsibility, in which the receivers collected and paid out about sixty million dollars, Judge Brewer allowed the two receivers for three years' services seventy thousand dollars each, though the receivers asked for a much larger sum and the master upon the testimony had allowed a much larger compensation.[233] In Virginia, where the code gives trustees who sell trust property two per cent. of the gross proceeds of sale as commissions, the same allowance was made to trustees upon the sale of a railroad.[234]

Where the receiver resides at a distance from the property and commits the active management to others, he is not entitled to full compensation.[235]

[231] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331.

[232] Hinckley v. Railroad Co. 100 U. S. 153. This was the first case in which the Supreme Court was called upon to review an allowance of compensation made by the circuit courts.

[233] Central Trust Co. v. Wabash &c. R. Co. 32 Fed. 187.

[234] Duncan v. Atlantic &c. R. Co. 4 Hughes (U. S.) 125.

[235] Central Trust Co. v. Cincinnati &c. R. Co. 58 Fed. 500.

§ 532a. The compensation of receivers should be restrained to reasonable charges measured, not by the highest salaries which large establishments may pay, but by analogy to such as the law allows to public officers having similar duties.[236] It should correspond with the degree of business capacity, integrity, and responsibility required in the management of his trust, and a reasonable and fair compensation should be allowed according to the circumstances of each case, to be determined from the court's own knowledge, aided, if in doubt, by the testimony of men of experience in such matters.[237]

§ 533. If the duties of the receiver prove to be more arduous than was anticipated when his compensation was agreed upon, and he has faithfully administered his trust, extra compensation may be allowed him by the court.[238] If a receiver has contracted to serve for a salary of three thousand dollars a year, and has entered upon his duties under an appointment fixing his salary at that sum, a court of equity will not release him from his agreement and add to his compensation, though this salary is inadequate, unless it be shown that his duties have been more arduous than he or the court expected, or that he performed duties in addition to those ordinarily required of a receiver.[239] Allowances of compensation should be made with moderation and with a jealous regard to the rights of those who are interested in the fund.[240]

§ 534. If the fund in court is not sufficient to afford compensation to the receivers, the bondholders at whose instance they were put in charge of the property will be required to provide the means of payment, by assessment or otherwise.[241] Receivers appointed solely at the instance and for the benefit of second mortgage bondholders are not entitled to compensation as against the first mortgage bondholders, unless they adopt the suit and assent to a sale

[236] Speiser v. Merchants' Exchange Bank, 110 Wis. 506; 86 N. W. 243.

[237] Union Nat. Bank v. Mills, 103 Wis. 39; 79 N. W. 20.

[238] Farmers' &c. Co. v. Central R. Co. 2 McCrary (U. S.) 318; 8 Fed. 60.

[239] Farmers' &c. Co. v. Central R. Co. 2 McCrary (U. S.) 318; 8 Fed. 60.

[240] Trustees v. Greenough, 105 U. S. 527. See Williams v. Morgan, 111 U. S. 684; 6 Sup. Ct. 638.

[241] Tome v. King, 64 Md. 166, 169; 21 Atl. 279.

of the entire property. If the first mortgage bondholders subsequently institute a foreclosure suit and sell the property on their own behalf, they are not liable to assessment for the commissions and expenses of the receivers under the subsequent mortgage. Where a receiver of a railroad company is appointed for the sole benefit of the company and its creditors, no part of the expenses of the receivership is chargeable against the property of another railroad company, leased to the company placed in the hands of the receiver, the receivership not being for the benefit of the lessor or its creditors.[242]

Where the receiver of a corporation and a depository of its funds both apply to a court for permission to make a payment on account of expenses and compensation, it is proper to allow a holder of bonds of the corporation to intervene in the proceeding to contest the allowance.[243]

§ 535. **A receiver's expense for counsel and witness fees, incurred in resisting a motion for his removal,** were allowed as a charge against the trust fund, in a case where it appeared that he had acted in good faith and with integrity of purpose, although it also appeared that there were apparent grounds for the motion.[244] The receiver's accounts in this case had been referred to two different masters, who found such confusion and vagueness in them that no satisfactory conclusion could be formed as to the condition of the trust, or as to the state of accounts with another railroad company. After repeated complaints, one of the masters refused to pass the receiver's accounts until they were rendered in a form calculated to give the information desired. After this was done a more satisfactory exhibit was made, but this was after the application for removal had been made. "I cannot say that the demands of the defendants for a more specific statement of the accounts were unreasonable; nor that the difficulties which were experienced in getting at an explanation of the various items were not calculated, in connection with other things, to raise suspicion as to the faithful management of the receivership. I think that these circumstances are sufficient to exonerate the de-

[242] Brown v. Toledo &c. R. Co. 35 Fed. 444.

[243] Girard Trust Co. v. McKinley-Lanning &c. Co. 135 Fed. 180.

[244] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331, 339; McLane v. Placerville &c. R. Co. 66 Cal. 606; 6 Pac. 748.

fendants from the burden of paying the costs and expenses incurred by the receiver. Are they sufficient to cast the burden on the receiver himself? If the receiver acted in good faith, and was ever ready, as far as he was able, to make any explanations that were personally required, but was unskillful in the manner of keeping his accounts, he ought not for that cause to be visited with a penalty. It is not every good business man, or engineer, or superintendent, that understands book-keeping. It requires a peculiar aptitude to state and keep accounts with clearness and accuracy, especially where the transactions are varied, extensive, and complicated. I should not feel disposed, therefore, to cast the burden of the expenses referred to on the receiver personally, unless satisfied that his method of keeping his accounts was adopted for the purpose of producing confusion and covering up the nature of his transactions. I do not see any sufficient evidence that this was the case."[245]

§ 536. **The receiver's legal adviser.**—The attorney of the bondholders, in obtaining the appointment of a receiver, should not be made the receiver's legal adviser pending the foreclosure proceedings. Neither should a relative of the receiver be appointed his legal adviser, nor one who has come from abroad and become a member of the bar of the circuit for the purpose of securing the appointment. In the absence of any special reason for so doing, the court will not go outside of the bar of the circuit in selecting such legal adviser.[246]

§ 537. **Allowances of counsel fees out of the fund in the hands of the court** are agreeable to the principles of equity, if made with moderation and a jealous regard to the rights of those who are interested in the fund.[247] The amount of such counsel fees is within

[245] Per Mr. Justice Bradley, in Cowdrey v. Railroad Co. 1 Woods (U. S.) 331, 339.

[246] Blair v. St. Louis &c. R. Co. 20 Fed. 348.

[247] Trustees v. Greenough, 105 U. S. 527, 536. Mr. Justice Bradley in this case said: "In the vast amount of litigation which has arisen in this country upon railroad mortgages, where various parties have intervened for the protection of their rights, and the fund has been subjected to the control of the court and placed in the hands of receivers or trustees, it has been the common practice, as well in the courts of the United States as in

the sound discretion of the court, subject to review on appeal. Such fees are allowed to the receiver and not to the counsel directly.[248]

An allowance of five thousand dollars made by the Circuit Court for the District of Texas for counsel fees, to be paid to counsel out of the proceeds of a railroad mortgage, was sustained by the Supreme Court.[249]

§ 538. If complainants' counsel present claims for professional services for allowance during the pendency of a receivership, the court will allow them only in part, leaving a balance to stand until the litigation is disposed of, if there is any possibility that the property in the receiver's hands will not suffice to pay all expenses, and the court will decide after the litigation is disposed of what final allowance should be made.[250]

Where counsel present a claim for services rendered both before and after the appointment of a receiver, the claim for services rendered after the appointment may be paid out of the funds in the receiver's hands; but the claim for services rendered before the appointment is payable only out of surplus remaining after satisfying the mortgage lien and all expenses.[251]

those of the states, to make fair and just allowances for expenses and counsel fees to the trustees or other parties promoting the litigation, and securing the due application of the property to the trusts and charges to which it was subject. Sometimes, no doubt, these allowances have been excessive, and perhaps illegal; and we would be very far from expressing our approval of such large allowances to trustees, receivers, and counsel as have sometimes been made, and which have justly excited severe criticism." See, also, Trust &c. Co. v. Spartanburg &c. Co. 97 Fed. 409.

[248] Crumlish v. Shenandoah Valley R. Co. 40 W. Va. 627; 22 S. E. 90.

[249] Cowdrey v. Galveston &c. R. Co. 93 U. S. 352. This was the amount agreed upon by the trustees to be paid for instituting proceedings which were discontinued by the intervention of the civil war. A new bill was afterwards filed by some of the bondholders, and the fund was brought into court, and the fee in question was directed to be paid by the receiver. Liberal allowances were also made by the circuit court in the same case for counsel fees and other charges incurred by the complainants in the cause, which were never brought to the Supreme Court for review.

[250] Central Trust Co v. Wabash &c. R. Co. 23 Fed. 675.

[251] Blair v. St. Louis &c. R. Co. 20 Fed. 351.

The receiver should not repay costs incurred by the plaintiff in the foreclosure suit in bringing the bill and obtaining the appointment of the receiver, while the litigation remains pending; for it may be that the plaintiff's demand is from the beginning wrongful, in which case he must bear the costs of the litigation himself.[252]

Where an individual bondholder brings a foreclosure suit, and cross-bills are filed, so that, as a result of the litigation, the property is sold free from all liens, counsel fees of the various parties will not be charged on the fund as a whole, but upon that part of the proceeds appropriated to the payment of each mortgage.[253]

§ 539. What payments and expenses a receiver may charge. —A receiver of a railroad was not allowed to charge in his account payments for advertising the accommodations of the road, when the advertisement contained a favorable reference to a firm of which he was a member, as proper persons to facilitate the forwarding of freight, and had for its object, in whole or in part, the promotion of the interests of that firm.[254]

Expenses incurred in negotiations for a reorganization of the corporation should not be ordered to be paid by a receiver, when it appears that there is no surplus in his hands, and that it is not certain that the negotiations will have any advantageous result.[255]

If a receiver of a railroad company employs a manager to perform duties which mainly should be performed by the receiver himself, and in a subsequent order for the distribution of the proceeds of the property after foreclosure, an amount is awarded to the receiver as compensation for his services, and he is directed to pay the manager a specified portion of this amount, the latter cannot compel the payment of this portion directly to himself, if he is at the time individually indebted to the receiver in a larger amount.[256]

A receiver of a small railroad in Kansas is not justified in charging as expenses large hotel bills in New York City, and is not justi-

[252] Olyphant v. St. Louis &c. Co. 22 Fed. 179.

[253] Bound v. South Carolina R. Co. 59 Fed. 509.

[254] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331.

[255] Central Trust Co. v. Wabash &c. R. Co. 25 Fed. 69.

[256] Gatzmer v. Philadelphia &c. R. Co. 39 N. J. Eq. 363.

fied in renting an office there without the express sanction of the court.[257] But traveling expenses of a receiver, incurred in going to and from his residence to the railroad property and elsewhere about the country in the interests of the property are properly allowed.[258]

§ 540. **A receiver may appeal from a decree directing him to pay into court a certain sum as the balance due from him** on the settlement of his accounts.[259] In taking such appeal he does not attempt to appeal from the decree of foreclosure, or from any order or decree of court, except such as relates to the settlement of his accounts. "To that extent," says Mr. Chief Justice Waite, of the Supreme Court of the United States, "he has been subjected to the jurisdiction of the court, and made liable to its orders and decrees. He has, therefore, the corresponding right to contend against all claims made against him. For this purpose he occupies the position of a party to the suit, although an officer of the court, and after the final decree below has the right to his appeal here."

A surety upon the bond of a receiver who, upon his removal from his trust, has been ordered to pay over a certain amount, being the balance of trust funds in his hands, is liable for such amount, although he was not a party to the proceeding which resulted in the order. A receiver appointed in place of the receiver removed may bring suit on the bonds.[260]

[257] Braman v. Farmers' &c. Co. 114 Fed. 18.

[258] Northern Alabama R. Co. v. Hopkins, 87 Fed. 505.

[259] Hinckley v. Gilman &c. R. Co. 94 U. S. 467, 469.

[260] Thomson v. McGregor, 13 J. & S. (N. Y.) 197.

CHAPTER XVI.

RECEIVERS' DEBTS AND CERTIFICATES.

I. For what purposes receivers may be authorized to incur debts and issue certificates, §§ 541–550.

II. Priority of receivers' certificates, §§ 551–564.

III. Negotiability of receivers' certificates, §§ 565, 566.

I. *For what Purposes Receivers may be authorized to incur Debts and issue Certificates.*

In the enforcement of railroad mortgages there is frequent occasion to invoke the aid of courts of equity to take possession of the property for its preservation. As shown in the preceding chapters, this is done through the agency of receivers. It may be necessary for receivers, in the proper management of the property, to use money beyond the current income of it; and it is usual for the courts to authorize receivers, for specific purposes, to negotiate loans upon the credit of the property. This authority of the courts, when properly exercised, is highly beneficial to the mortgage bondholders. What are the proper occasions for the exercise of this power is the first subject for consideration.

§ **541. General principles.**—Under the common law rules, a mortgagee in possession has authority to make necessary and reasonable repairs, and to protect the title from other incumbrances. He has, however, no right to make the estate better by expenditures for convenience or ornament. He has no right to lay out money in ways not essential to the preservation of the property, although he may

think that the value of it will thus be increased. This would be improving a mortgagor out of his estate.[1]

This principle of the general law of mortgages governs courts and receivers in the management of railroad property, pending litigation respecting it. A receiver is generally appointed at the instance of a mortgagee, and the receiver's possession is only a substitute for the possession of the mortgagee. As against the mortgagor, the same rules govern as to the expenditures a receiver may make and charge upon the property that govern when a mortgagee is himself in possession. A receiver has no greater right than a mortgagee to improve the mortgagor out of his estate. It does not alter the rule in this respect, that generally when the affairs of a railroad company become so embarrassed that the mortgagee is obliged to assume possession of the road, either directly or through the intervention of a receiver, in order to protect the mortgage title and interest, the company itself practically ceases to have any interest in the road, and rarely is able to redeem. The right of redemption remains until finally barred by foreclosure proceedings, and must be protected, though it be seldom or never exercised.

Complaint as to the management of railroad receivers has generally come, not from the stockholders of the corporation, because it is seldom they care to redeem, but from mortgage bondholders; and as often, perhaps, from those at whose solicitation the receiver was appointed as from others may hold under junior mortgages, and who, therefore, have a right to redeem. The history of such management in this country shows that the bondholders chiefly interested have sometimes found themselves improved out of their interest in the property. The management of mortgage trustees in possession has sometimes been open to the same criticism; but in such case the remedy is more completely in the hands of the bondholders themselves.[2]

[1] Sandon v. Hooper, 6 Beav. 246; 2 Jones Mortg. § 1126.

[2] Judge Baxter is reported to have expressed himself strongly, in a recent case before the Circuit Court of the United States, against the practice of placing railroads in the hands of receivers. He cited the case of a railroad in Georgia which cost $15,000,000. The receiver, who was in charge for three years, issued certificates to the value of $1,500,000, and when the road was sold the proceeds were not sufficient to pay the certificates. In another case, in Detroit, a road

The power, therefore, of a court of chancery to authorize a receiver to create liens upon a railroad should, upon principle, be limited to cases in which the creation of such liens is indispensable to the preservation of the property pending litigation.[3] The nature of railroad property is such, however, that a liberal construction must be given to the power to authorize repairs; for a railroad already in operation must be kept in operation, so that it may be sold as a going concern, else the property itself would seriously deteriorate in value, and its business would be lost. In analogy to the right of a mortgagee in possession to supply things necessary to put a house upon the estate in a condition to be rented, or to be occupied, the receiver of a railroad may supply it with rolling stock, or with other things essential to the operating of the road.[4]

§ 542. The receiver has no power, without the authority of the court whose officer he is, to make a contract which will bind the trust. Ordinary expenditures made by a receiver in good faith will be allowed by the court when he comes to account for the administration of his trust. But in all cases, where a large outlay of money is involved, the receiver should apply to the court in advance for authority to make the expenditure proposed.[5]

cost over $8,000,000. When the road came to be sold, eminent counsel requested the judge to fix the minimum price for the sale, suggesting that such price should be a sum sufficient to cover the charges of the receiver and his counsel. 11 Chic. L. N. 8.

[3] Meyer v. Johnston, 53 Ala. 237; Wallace v. Loomis, 97 U. S. 146. "It is a power to be sparingly exercised. It is liable to great abuse; and while it is usually resorted to under the pretext that it will enhance the security of the bondholders, it not unfrequently results in taking from them the security they already have, and appropriating it to pay debt contracted by the court. The history of Wallace v. Loomis, 97 U. S. 146, 162; 2 Woods (U. S.) 506, under title of Stanton v. Alabama &c. R. Co., furnishes an instructive lesson on this subject." Per Caldwell, J., in Credit Co. v Arkansas Cent. R. Co. 5 McCrary (U. S.) 23.

[4] McLane v. Placerville &c. R. Co. 66 Cal. 606; 7 Pac. 748; Hale v. Nashua &c. R. 60 N. H. 333; Gibert v. Washington City &c. R. Co. 33 Gratt. (Va.) 586; Woodruff v. Erie R. Co. 93 N. Y. 609; Vilas v. Page, 106 N. Y. 439; 13 N. E. 743; Wallace v. Loomis, 97 U. S. 146, 162; 2 Woods (U. S.) 506; Union Trust Co. v. Illinois &c. R. Co. 117 U. S. 434; 6 Sup. Ct. 809.

[5] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331, 336, per Brad-

Contracts made by a receiver without the authority of the court are subject to the control of the court, which may modify them or disregard them entirely, as it may seem best.[6]

A receiver cannot without an order of court grant to another railroad corporation the privilege of crossing the road he represents, for such a right is a right of property, even though the company represented by the receiver does not own the fee.[7]

The authority of the court to manage the property and direct the expenditure of money for its protection continues even after a foreclosure sale, and until the sale is completed and a conveyance made.[8]

§ 543. The legitimate object of a court of equity in the assumption of the management of a railroad is the preservation of the property, and the enforcement of the right of creditors and others interested in it. The power of the court over the property should be limited to preserving the property as it is, and there is no principle of law or of public policy which will justify a court in engaging in the completion of unfinished roads, and in authorizing the expenditure of large sums of money for this purpose, except with the consent of the mortgage creditors whose interests may be thereby affected. Such a course is open to the objections that the liens of mortgage creditors are thus without their consent, displaced by new liens; and that, in engaging in such new undertakings, the court lays aside its judicial character and functions. The whole power of the court, when exercised to its fullest extent, without the consent of the lien-holders, express or implied, is confined to making necessary repairs and protecting the property as it is.[9] The nature of the property being such that, to prevent serious injury and depreciation

ley, J.; Vilas v. Page, 106 N. Y. 439; 13 N. E. 743, affirming 30 Hun (N. Y.) 222; Lehigh Coal &c. Co. v. Central R. Co. 35 N. J. Eq. 426; 35 N. J. Eq. 379; United States Inv. Co. v. Portland Hospital, 40 Or. 523; 64 Pac. 644; 67 Pac. 194; 56 L. R. A. 627.

[6] Lehigh Coal &c. Co. v. Central R. Co. 35 N. J. Eq. 426; 35 N. J. Eq. 379.

[7] Howlett v. New York &c. R. Co. 14 Abb. N. C. (N. Y.) 328.

[8] Vilas v. Page, 106 N. Y. 439; 13 N. E. 743.

[9] Snow v. Winslow, 54 Iowa, 200; 6 N. W. 191; Taylor v. Philadelphia &c. R. Co. 9 Fed. 1; Credit Co. v. Arkansas &c. R. Co. 5 McCrary (U. S.) 23; Metropolitan Trust Co. v. Tonawanda &c. R. Co. 103 N. Y. 245; 8 N. E. 488, per Danforth, J.

in value, the road must be continued in operation and sold as a going concern, the court may continue the running of trains and the usual business of the road. For the economical conservation of the property in this way, the court may, perhaps, under some circumstances, authorize expenditures for rolling stock, and for other things essential to the operation of the road; and, if the income of the road is insufficient for such purpose, may provide the requisite means by creating charges upon the property.[10]

Where, however, the net earnings of a railroad are sufficient to pay for necessary rolling stock, the court will not authorize the receivers to raise money for the purchase of such rolling stock by creating a car trust, in order to allow of the paying of the income to the bondholders.[11]

This equitable power may be exercised not only when a receiver has been appointed upon the application of a mortgagee, but also when the appointment has been made under proceedings in insolvency instituted against a railroad company. There can be no doubt of the duty of the court in such case to order the receiver to keep the road in repair, so that it may be operated with safety to the public, and without impairing the value of the trust estate; and it may be the duty of the court to provide the means of making such repairs by a pledge of the property. The power of the court to act in such case does not depend upon the statute, but upon the general equity jurisdiction of the court.[12]

§ 544. To preserve the road as a whole, and to prevent loss or depreciation, it may be necessary to rebuild, or even to build anew, inconsiderable portions of it.[13] Thus, where it was necessary to com-

[10] Meyer v. Johnston, 53 Ala. 237, 346, and cases cited; Vilas v. Page, 106 N. Y. 439; 13 N. E. 743, affirming 30 Hun (N. Y.) 222.

[11] Taylor v. Philadelphia &c. R. Co. 9 Fed. 1; Philadelphia & Reading R. Co.'s Receivers, in re, 14 Phila (Pa.) 501; 38 Leg. Int. 393.

[12] Hoover v. Montclair &c. R. Co. 29 N. J. Eq. 4.

[13] Snow v. Winslow, 54 Iowa, 200; 6 N. W. 191. The completion of a road by receivers will not be enjoined at the suit of a property holder along its route, on the ground of the invalidity of the receivers' certificates to be issued to raise funds for such construction. That question concerns only those who propose to make advances upon them. Moran v. Lydecker, 11 Abb. N. C. (N. Y.) 298.

plete a road before a certain date, in order to secure a land grant, which was a very material part of the security of the bondholders. Judge Dillon authorized a receiver to borrow money, and complete the road within the time limited. The exigency of the case demanded an unusual exercise of power for the preservation of the security.[14] "It is manifest," said Judge Dillon, "that unless a receiver is appointed, no further work will be done on the extension lines, and that the land grant, which is the only security of any considerable value which the plaintiffs and the other bondholders have for their large advances, will lapse and be wholly lost. In order to save this land grant, the road must be completed by December third ensuing, and it seems to me that the exigencies of the case are such as, under the circumstances, to warrant the court, upon the application of the parties chiefly interested, to appoint a receiver and clothe him with the authority desired." Both the opinion of the court and the order made show the urgent necessity of appointing a receiver for the protection and preservation of the security.

The Supreme Court of the United States in a recent case approved of receivers' certificates issued for the completion of a canal, in aid of which the United States had made a large grant of land conditioned upon the completion of the canal within a fixed time.[15] "Hence there was a necessity for making the order which the court made,—a necessity attending the administration of the trust which the court had undertaken. The order was necessary alike for the lien creditors and for the mortgagors."[16]

In a case before the Supreme Court of Iowa it appeared that the

[14] Kennedy v. St. Paul &c. R. Co. 2 Dill. (U. S.) 448, 454, 458; 5 Dill. (U. S.) 519. In this case a sum not exceeding $5,000,000 was authorized. See note to this case for form of the order of court, and form of certificate authorized to be given for the money borrowed. The order is most carefully drawn. Among other things it explicitly states that "the main effect of this order is to insure the completion of said roads by the third day of December next, and the receiver is instructed so to act, under the limitations aforesaid, as to see that this object shall be accomplished, and to proceed at once, and with expedition." See, to similar effect, Allen v. Dallas &c. R. Co. 3 Woods (U. S.) 316.

[15] Jerome v. McCarter, 94 U. S. 734, 738; Kent v. Lake Superior Canal Co. 144 U. S. 75, 89; 12 Sup. Ct. 650.

[16] Per Strong, J., in Jerome v. McCarter, 94 U. S. 734, 738.

receiver had been authorized to complete and build all the unconstructed portion of the railroad in his hands, from Clinton to Iowa City, in that state, and to that end to borrow such sums of money as might be necessary, not exceeding eight thousand dollars per mile upon the whole line of road, completed and to be completed, and to make the same a first lien upon the property. The propriety of constructing portions of the road was not, however, a question before the court.[17]

Mr. Justice Bradley appointed receivers, pending a foreclosure suit, of a railroad which had been built so far as to enable trains to run over the road, but a portion of which had been built in a hasty and temporary manner, and needed to be completed in a substantial way in order to insure the safety of the trains; and authorized them to put the road in repair, and to complete any incomplete portion of it; to procure rolling stock, machinery, and other things necessary for operating the road to the best advantage, and save and preserve it for the benefit of the mortgage bondholders. They were authorized to borrow money for these purposes, and make the payment of it a first lien upon the property. The order for the borrowing of this money was asked for by the mortgagees themselves; and consequently they were precluded from objecting to the effect of what they had asked for and consented to.[18]

The necessity of the expenditure for the protection of the property is the criterion of its propriety.[19] Thus, the Circuit Court of the United States, after an appeal of the principal cause to the Supreme Court of the United States, refused to authorize a receiver in possession of the property to make any radical change in the condition of the railroad property, such as purchasing a bridge across Galveston Bay, or building or contracting to use a new junction road through the city of Houston.[20]

§ 545. But the court will not authorize expenditures for the completion of a road unless it is morally certain that the property

[17] Bank of Montreal v. Chicago &c. R. Co. 48 Iowa, 518; 7 Cent. L. J. 267.

[18] Stanton v. Alabama &c. R. Co. 2 Woods (U. S.) 506.

[19] Shaw v. Railroad Co. 100 U. S. 605; Hale v. Nashua &c. R. Co. 60 N. H. 333, 341, per Allen, J.

[20] Cowdrey v. Railroad Co. 1 Woods (U. S.) 331.

in consequence will sell for a higher price. In the case of an insolvent corporation, with a road that is wrecked, a business that is wholly local, and a future in regard to which no certain prediction could be made, even if the road be put in running order, with an equipment of its own, the court will not authorize the issue of certificates to raise money for completing the road except upon the consent of all the bondholders.[21]

It is not a part of the duty of a court to build railroads, and the assent of all the parties interested in the property cannot make it such. Nor is there any difference in principle between building a railroad and making extensive and general repairs and betterments which approximate the cost of original construction. Instead of issuing receivers' certificates in such case, the much more desirable plan is to stop running the road and speed the foreclosure.[22]

It has been declared to be an unwarranted exercise of power by a court of equity to authorize its receiver to issue certificates for the purpose of completing a railroad. Where only one-third of a railroad is built and the value does not exceed the amount of the mortgage, so that the bondholders are equitable owners, the court is not warranted in authorizing the receiver to complete the road, over the objection of the lienholders.[23] Furthermore, certificates to provide for new equipment, additional sidings, and permanent structures will not be issued against the opposition of first mortgage bondholders.[24]

[21] Investment Co. v. Ohio &c. R. Co. 36 Fed. 48, 52. "If the court authorizes certificates to be issued, and made a lien upon the railroad superior to the mortgages, for the purchase and laying of steel rails, for the purchase of equipment, and for the completion of the road, the result may be to cause those things to be done at the expense and to the detriment of the bond and lienholders, and for the benefit of the purchasers, or of a syndicate holding a majority in amount of the bonds and liens, having peculiar advantages as bidders, and intending to become purchasers at the sale; for it rarely occurs that improvements and betterments add to the salable value of the road anything near their cost. In this case the court cannot say that they would at all increase the bids at the sale, which, in the condition of the railroad company and of the road, is the proper test." Per Sage, J.

[22] Credit Co. v. Arkansas Central R. Co. 5 McCrary (U. S.), 23; Shaw v. Railroad Co. 100 U. S. 605, 612.

[23] Bibber-White Co. v. White River &c. R. Co. 115 Fed. 786.

[24] Street v. Maryland Central R. Co. 59 Fed. 25.

The accepted rule is that a court of equity should not exercise this power for the purpose of building an extension or addition to the railroad except in case of an overwhelming and irresistible necessity, and for the purpose of preserving the property and franchises of the corporation.[25]

§ 546. **The proper functions of a court of chancery in the management of a railroad through a receiver** are well stated in the case of The Vermont and Canada Railroad Company v. The Vermont Central Railroad Company.[26] Mr. Justice Barrett said: "It is fundamental that, in a receivership involving and requiring the carrying on of a business, in order to meet the exigency which caused the necessity for it, and made it the duty of the court to create and maintain it, such receivership should not go outside of the subject and purpose of it, and what is necessarily incidental thereto. . . . While the current use of the property looked especially to the realizing of net income, the property itself was not, for that reason, to be subjected to deterioration and waste; but it should be kept in proper condition, not only for doing the current business during the receivership, but for continuing to do it, without the necessity for special and extraordinary outlay on passing back to the possession and use of the owners. But, for any legitimate purpose, the receivership could not be extended to the control and maintaining and repairing and equipping other roads, or to the building or buying of other roads, or to the control and operating of lines of steamboats, or steamboats in the line of other roads, even with the view of larger earnings, and larger net income of the property which is the subject of the receiv-

[25] Pueblo Traction &c. Co. v. Allison, 30 Colo. 337; 70 Pac. 424; Fidelity Ins. &c. Co. v. Roanoke Iron Co. 68 Fed. 623.

[26] 50 Vt. 500, 569, 570; 14 Am. Railw. R. 497, 545, 546, 552. But it does not follow that a long-continued receivership is not sometimes necessary. "The theory is that our possession is only temporary," remarked Judge Drummond, in a recent case in the Seventh Circuit, "but there is generally such a multitude of claims to be adjudged in each case, and so great are the difficulties in arranging conflicting rights among the mortgagees preparatory to a sale and reorganization that it sometimes happens, in spite of the earnest efforts of the court to hasten the sale by foreclosure, that they remain in the custody of the court for some years." Secor v. Toledo &c. R. Co. 7 Biss. (U. S.) 513.

ership. . . . It is fundamental in the law that a receivership is temporary,—to serve an existing exigency of a temporary nature; and, when that is done, it is to cease. The idea that a court, in virtue of its prerogative in that behalf, is to take upon itself the office of instituting a receivership to be perpetual, and to do the duty of a court in controlling, directing, and enforcing the administration in the management of a business, for the profit and emolument of the parties interested, and not to serve a present exigency, rendering it necessary in order to prevent a failure of legal justice and right, has not yet been propounded in any book on the subject, nor entertained and acted upon in any case."

§ 547. As a general proposition it may be said that the necessity of the expenditure is the criterion of its propriety. The necessity may be more imperative in one instance than in another. In one class of cases the necessity may be absolute and direct; and in another it may be indirect and less obvious.

The wages of employes engaged in operating a railroad are a necessary expenditure; and where an employe sustained an injury in the line of his duty, though the company or the receiver in charge of its property may not have been guilty of any negligence, yet the receiver may be authorized as a matter of policy to pay the employe's wages for a reasonable time during his recovery from the injuries received.[27]

In a foreclosure suit under a mortgage of a consolidated line, the receiver was authorized to issue certificates for future interest due upon prior mortgage bonds of separate divisions of the road to bondholders who were willing to extend the time of payment of their bonds for ten years, with the right on the part of the receiver to pay them at any time within such period of extension. This was done in order to prevent the disintegration of the consolidated line by foreclosure sales under the prior divisional mortgages.[28]

Claims against a railroad for personal injuries received while a receiver is operating the road are one of the expenses of administration to be allowed in accounts of the receiver.[29] So also it has been de-

[27] Missouri &c. R. Co. v. Texas &c. R. Co. 33 Fed. 701.

[28] Atlantic &c. R. in re, 3 Hughes (U. S.) 320.

[29] Anderson v. Condict, 93 Fed. 349; Cross v. Evans, 86 Fed. 1.

clared that the compensation for an attorney for the receiver, the receiver having been discharged and the property surrendered to the owner, is a proper preferred charge against the property.[30]

But where the payment of interest on a divisional mortgage is not necessary to preserve the road as a whole, payment should not be ordered.[31]

§ 547a. **However under special circumstances it was held proper for a receiver,** with the authority of the court, to pledge collateral and equitable assets of the company to secure loans necessary to its operation, and also to incur a liability for the expenses of a refunding scheme.[32]

Pending a contested foreclosure suit, it is not proper to order the receiver to pay office expenses and counsel fees for the mortgagor company, as the bonds are *prima facie* valid, and all the assets belong to the bondholders.[33] Grading and paving between rails of a street railway are not necessary expenses, and consequently a receiver will not be directed to pay out money in his hands for the purpose of grading and macadamizing a street along and between the rails, in accordance with an order of town trustees.[34]

§ 548. **A receiver may be authorized to take a lease of another railroad,** where it is manifestly for the interest of the creditors and of the company that he should do so.[35]

[30] Pennsylvania Co. v. Jacksonville &c. R. Co. 93 Fed. 60.

[31] Cleveland &c. R. Co. v. Knickerbocker Trust Co. 64 Fed. 623.

[32] Clark v. Central R. & Banking Co. 54 Fed. 556.

[33] Union Loan &c. Co. v. Southern &c. R. Co. 51 Fed. 106.

[34] Union &c. Co. v. Southern &c. R. Co. 49 Fed. 270.

[35] Gibert v. Washington City &c. R. Co. 33 Gratt. (Va.) 586, 603. "A court of equity, having in charge the mortgaged property of a railroad company, is authorized to do all acts that may be necessary within its corporate power to preserve the property, and to give to it additional value, not only for the benefit of the lien creditors, but also for the benefit of the company, whose possession the court has displaced by the appointment of a receiver, and by taking into its own hands the property, rights, works, and franchises of the company. Any act, it would seem, necessary for the protection and preservation of the property, is a legitimate and proper act, and whatever is manifestly appropriate to such preservation and protec-

The rental of a leased track may be a receivership expense entitled to priority of payment over an outstanding mortgage. The continuity and operation of the main line being admitted by all the parties to the record to be dependent upon the leased track, coupled with an order of the court that the receivers perform the contract of lease, are distinguishing points in such a case. The propriety and necessity of such an order pertains to the administrative discretion of the court in managing the estate.[36]

§ 549. When it is necessary for the receiver to raise money for the purpose of repairing or operating a railroad, the court may authorize him to issue negotiable certificates of indebtedness, which shall constitute a first lien upon the property or the proceeds of it, and shall be redeemable within a limited time, or when the property is sold by the court.[37] The issuing of such certificates is a matter of hardly less importance than the appointment of receivers, and should not be authorized except after full notice to the parties interested, and ample opportunity for them to be heard. The receiver should make a detailed statement of the sums needed, and the purposes for which they are needed, and clear proof should be adduced of the correctness of this statement, and of the necessity of raising the money. Such certificates are not debts of the company, but of the receivers, backed by the pledged faith of the court that the property on which they are made a charge is in the possession of the court, and that it will provide for the payment of such certificates before the property or the proceeds of it shall pass out of its control. They should, therefore, be issued with the utmost circumspection, and never in excess of the urgent present need.[38]

tion, or to the enhancement of the value of the property, not in excess of the powers of the corporation, will always be upheld and enforced by the courts." Per Christian, J.

[36] Central Trust Co. v. Continental Trust Co. 86 Fed. 517; 30 C. C. A. 235.

[37] Taylor v. Philadelphia &c. R. Co. 14 Phila. (Pa.) 451, 461; Central Trust Co. v. Tappan (N. Y.) 6 Rail. & Corp. L. J. 489.

[38] Meyer v. Johnston, 53 Ala. 237, 336; Hoover v. Montclair &c. R. Co. 29 N. J. Eq. 4. The order authorizing the certificates in the latter case declared them to be a debt incurred for the benefit and protection of the property, and to be the first lien upon it, and on the net receipts, rents, income, and

An order of court authorizing the issuing of receivers' certificates is a final one, from which an appeal may be taken.[39]

§ 550. Such certificates may be issued for material furnished or for labor performed, as well as for money borrowed, provided they are issued for an adequate consideration received.[40] The receivers of the New Jersey Midland Railway Company, upon their appointment, found in the possession of the company several locomotive engines and tenders, held under a lease from the makers, which provided that, upon the payment in full of all the rent reserved, the property should belong to the railway company. The receivers requested the owners of the engines and tenders to leave them in their possession for the use of the road, promising to apply to the court for authority to pay the rent due under the lease, and on the faith of this promise the owners permitted the property to remain in their hands. The receivers afterwards obtained authority to issue certain certificates of indebtedness, to be used for the purposes of their trust, among which was the payment of the rent which had become due upon the engines.

The receivers offered to deliver certificates so obtained in payment for the rent, and the offer was accepted. They were, however, notified by persons interested in the mortgage bonds of the road not to deliver the certificates, because the property was not worth the amount agreed to be paid for it, and the receivers accordingly refused to deliver the certificates. An application was made by the owners of the engines to compel the receivers to deliver the certificates to them, but the chancellor held that the receivers were not bound to deliver the certificates in payment of particular items of expense, the propriety of the payment of which was not before the court; but they were authorized by the court to purchase the locomotives and tenders at their true value, and to pay for them in the certificates; otherwise the owners of this rolling stock, having the power at any time

profits of the railroad: the net receipts, &c., to be applied to the payment thereof before recourse is had to the property itself.

[39] Farmers' &c. Co. ex parte, 5 Railw. & Corp. L. J. 123.

[40] Taylor v. Philadelphia &c. R. Co. 14 Phila. (Pa.) 451, 461; People v. Erie R. Co. 54 How. Pr. (N. Y.) 59.

to take the property, might do so, and they should be allowed just compensation for the use of it since it had been in the hands of the receivers.[41]

II. *Priority of Receivers' Certificates.*

§ 551. The question of the priority of receivers' certificates and loans over existing mortgage liens has not very often been a matter of litigation; because in almost all instances in which the courts have authorized receivers to borrow money and make their obligations a first lien upon the property, the mortgagees have themselves asked for the orders for these purposes in advance,[42] or have expressly assented to the making of them, and, of course, they are in such cases precluded from afterwards claiming any priority over the lien thus created for the purpose of preserving the mortgaged property.[43] But it is claimed that courts of equity have authority, without the consent of mortgagees, to order receivers to borrow money, and to bind the property in their hands for the payment of the loans. This authority, if it exists at all, is not, however, altogether discretionary; the judicial discretion is limited by settled principles of equity.[44] Aside from any consideration of the mortgagor and others having the right to redeem, against whom a court of equity has power analogous to that of a mortgagee in possession to incur charges for the preservation and repair of the property it has taken possession of through its receiver, a court of chancery has no power to impair the obligation of a mortgage contract, by creating a superior lien without the mortgagee's consent, unless it be in the exercise of a like equitable power of preserving and protecting the property. The law does not permit the obligation of contracts to be impaired.

[41] Coe v. New Jersey &c. R. Co. 27 N. J. Eq. 37.

[42] As in Kennedy v. St. Paul &c. R. Co. 2 Dill. (U. S.) 448; 5 Dill. (U. S.) 519; Stanton v. Alabama &c. R. Co. 2 Woods (U. S.) 506; Vermont &c. R. Co. v. Vermont Central R. Co. 50 Vt. 500; and Hoover v. Montclair &c. R. Co. 29 N. J. Eq. 4; Central Trust Co. v. Seasongood, 130 U. S. 482; 9 Sup. Ct. 575; Manhattan Trust Co. v. Seattle &c. Co. 16 Wash. 499; 48 Pac. 333, 737.

[43] Reinhart v. Augusta &c. Co. 94 Fed. 901.

[44] Meyer v. Johnston, 53 Ala. 237, 345.

"The Constitution of the United States inhibits even a state from doing an act which shall have that effect. And, certainly, a court, which is a portion of the government of the state, cannot have a power which is denied to the state in convention assembled. If, therefore, the action of a chancellor in this cause goes to the extent of taking the property of the defendant corporation into his hands for the purpose, through his appointees, of completing an unfinished work, or of enlarging or improving a finished one, beyond what is necessary for its preservation, and to that end of raising money, by charging the railroad and its appurtenances with liens which are to supersede older ones, without the consent of the holders of these, he has inadvertently passed beyond the boundaries of a chancellor's jurisdiction. In our opinion, no such power is vested or resides in any judicial tribunal."[45]

§ 551a. For the preservation and management of the property the court may authorize a receiver to borrow money and to make the loan a lien upon the property; and the priority of such lien is not affected by the fact that the suit in which the receiver was appointed was not brought by the bondholders or their trustees.[46] Where a foreclosure decree directs the payment of "costs of suit" prior to the mortgage debt, certificates for debts contracted by the receiver are included as "costs."[47]

The question of the priority of receivers' certificates may arise with reference to three classes of creditors: first, with reference to the bondholders secured by the mortgage for the enforcement of which the receiver was appointed; second, with reference to prior mortgagees; and, third, with reference to subsequent mortgagees. Owners of the equity of redemption stand in the same legal relation to such certificates as subsequent mortgagees, since they have the same right of redemption.

Necessary supplies purchased on credit by the receiver, if not paid out of net earnings are a charge upon the fund realized from the

[45] Per Manning, J., in Meyer v. Johnston, 53 Ala. 237, 345.

[46] Union Trust Co. v. Illinois &c. R. Co. 117 U. S. 434; 6 Sup. Ct. 809; Wallace v. Loomis, 97 U. S. 146.

[47] Farmers' &c. Co. v. Stuttgart &c. R. Co. 106 Fed. 565; Karn v. Rorer Iron Co. 86 Va. 754; 11 S. E. 431, citing text.

foreclosure sale; and where the mortgaged property consists of two divisions of a railroad which are sold separately, it will be presumed that the court below has correctly distributed such charges among the different divisions.[48]

§ 552. When bondholders, or trustees in their behalf, after obtaining the appointment of receivers, have petitioned that they might be allowed to borrow money on the credit of the property, there can be no question that they waive the priority secured to them by their mortgage in favor of such debts. Even when their waiver is not expressly made, it is implied under such circumstances. Moreover, even if such petition be not made by or in behalf of such bondholders, but by the receiver himself, or by any other creditors, if the bondholders or mortgage trustees, being parties to the proceedings and before the court, make no objection to the creating of such debts and liens upon the property by the receivers, they cannot afterwards object to according priority to the liens so created.[49]

Furthermore it has been declared to be within the discretion reposed in a trustee by an ordinary deed of trust to consent that receivers' certificates shall be a paramount lien upon the mortgaged property. If the trustee acts in good faith, whatever legal proceeding in regard to the trust estate binds him, binds the bondholder as well.[50]

If a mortgagee has procured the appointment of a receiver, with power to control and operate a mortgaged railroad, he cannot well object to the depreciation of his mortgage security through expenses incurred by the receiver for these purposes, but he may properly object to any expenses incurred previous to such appointment.[51] The order appointing a receiver and authorizing him to pay certain claims

[48] Kneeland v. Bass &c. Works, 140 U. S. 592; 11 Sup. Ct. 857.

[49] §§ 551, 563; Humphreys v. Allen, 101 Ill. 490; Metropolitan Trust Co. v. Tonawanda &c. R. Co. 103 N. Y. 245; 8 N. E. 488, reversing 40 Hun (N. Y.) 80; Kneeland v. Luce, 141 U. S. 491; 12 Sup. Ct. 32. See, also, Blythe v. Gibbons, 141 Ind. 332; 35 N. E. 557.

[50] Kent v. Lake Superior Canal Co. 144 U. S. 75; 12 Sup. Ct. 650.

[51] Metropolitan Trust Co. v. Tonawanda &c. R. Co. 103 N. Y. 245; 8 N. E. 488, reversing 40 Hun (N. Y.) 80, per Danforth, J.; Vatable v. New York &c. R. Co. 96 N. Y. 49; Hand v. Savannah &c. R. Co. 17 S. C. 219; Heisen v. Binz, 147 Ind. 284; 45 N. E. 104.

in priority to the mortgaged debt, is an assent by those asking the appointment to such priority.[52]

§ 552a. Receivers' certificates take preference over a valid lien for rails furnished a road, the true doctrine being that all claims against a railroad as debtor, whatever their priority as between creditors, become subordinated to the power of the court to operate the property. As expenses of legitimate administration, the receivers' certificates must be met before questions of priority among creditors is reached.[53]

§ 553. When receivers have obtained loans upon the credit of the property with the knowledge and assent of all the parties interested in the property, such parties are estopped to deny that such loans are entitled to priority of payment from the assets of the trust; and they are also estopped to deny that the receivers were at the time the loans were made strictly receivers, because the specific purpose for which they were appointed had been accomplished. It is in such case immaterial whether they were acting strictly as receivers or not. Purchasers of the securities issued by them, having relied upon their apparent authority, are entitled to protection; and the parties in interest who gave the receivers the power or opportunity to act, must bear the burden of the consequences.[54]

Bondholders who have at public meetings chosen committees to advise with receivers as to the management of the property are bound by the acts of such committees within the scope of their authority; and the consent or advice of such committees that loans be issued by the receivers for the benefit and conservation of the property is a matter within the authority of such committees, and binds the bondholders.[55]

§ 554. Upon the question of the power of courts to give receivers' loans precedence over existing mortgages there are con-

[52] Guarantee &c. Co. v. Philadelphia &c. R. Co. 31 App. Div. (N. Y.) 511; 52 N. Y. S. 116.

[53] Royal Trust Co. v. Washburn &c. R. Co. 120 Fed. 11.

[54] Langdon v. Vermont &c. R. Co 53 Vt. 228.

[55] Langdon v. Vermont &c. R. Co. 53 Vt. 228.

flicting adjudications. It is claimed on the one hand that this power is confined to cases in which the prior mortgagees, either expressly or impliedly, consent to the making of such loans; and that to attempt this without such consent would be an invasion of the right of property by the tribunals whose duty it is to protect this fundamental right. But, on the other hand, it is claimed that where it is necessary to raise money, not to extend or improve an existing road, but to repair and preserve a road which the court has taken custody of at the suit of a junior mortgagee, it would be competent for the court to authorize the raising of money by loans upon the credit of the entire property, making them a lien upon it in preference to the senior mortgages. Otherwise, it is said, it might be practically impossible for the court to give any protection to a junior mortgagee. The property might be amply sufficient to meet a prior mortgage in any event, so that the bondholders under it might be opposed to any expenditure upon the property, even to keep it in repair and in operation, when such expenditure might involve the raising of money, by creating liens therefor which should override their mortgage; while it might be evident that, by judiciously repairing and operating the road, the property might finally be disposed of at a price sufficient to pay not only the first mortgage, but as well the junior mortgage. Moreover, after the court has once taken the property into its custody, it would be its duty, in behalf of all the parties in interest, to take care of it, and not allow it to go to decay; and, if this cannot be done out of the income of the property, it would seem to follow that it would then be the duty of the court to authorize, for this purpose, the raising of money upon the credit of the property itself.

Such was the course adopted by the Supreme Court of Alabama in a very important case.[56] A receiver having been appointed upon

[56] Meyer v. Johnston, 53 Ala. 237, 348. "If it were not for the public quality belonging to them, for the injury that would be done to the interests of whole communities that have become dependent on a railroad for accommodation in a thousand things, a chancellor might say to the parties most interested, Unless you furnish means for the protection of this property, which does not itself afford an adequate income for the purpose, it may become a dilapidated and useless wreck. But the inconvenience and loss which this would inflict on the population of large districts, coupled with the benefit to parties who,

the appplication of a junior mortgagee, the court approved of his issuing of first lien certificates of indebtedness, under the chancellor's direction in opposition to the will of prior lien-holders. In addition to the duty of the court to preserve the property in its custody, the public nature of railroads was considered.

§ 555. As regards the debts which receivers may incur, cases arising under railroad receiverships are to be distinguished from all others. The public have an interest in the successful and continued operation of railroads; and the courts sometimes authorize expenditures by receivers of railroad companies, to secure their uninterrupted operation, which they would not authorize receivers of ordinary business corporations to make. By reason of the public character of railroad corporations, the courts exercise a broad and comprehensive jurisdiction in authorizing expenditures by receivers of such corporations, and in giving such expenditures priority of payment over the liens of existing mortgages. But as regards other corporations the courts deem it "unwise to extend their power in dealing with property in the hands of receivers, to the practical subversion or destruction of vested interests. It is best for all that the integrity of contracts should be strictly guarded and maintained, and that a rigid, rather than a liberal, construction of the power of the court to subject property in the hands of receivers to charges, to the prejudice of creditors, should be adopted."[57]

perhaps, are powerless to take care of themselves, of preventing the rapid diminution of value, and derangement and disorganization that would otherwise result, seem to require—not for the completion of an unfinished work, or the improvement, beyond what is necessary for its preservation, of an existing one, but to keep it up, to conserve it as railroad property, if the court has been obliged to take possession of it—that the court should borrow money for that purpose, if it cannot otherwise do so in sufficiently large sums, by causing negotiable certificates of indebtedness to be issued, constituting a first lien on the proceeds of the property, and redeemable when it is sold or disposed of by the court."

[57] Raht v. Attrill, 106 N. Y. 423; 13 N. E. 282, 286; 60 Am. R. 456, per Andrews, J.; International Trust Co. v. United Coal Co. 27 Colo. 246; 60 Pac. 621; 83 Am. St. 59n; Hooper v. Central Trust Co. 81 Md. 559, 591; 32 Atl. 505; 29 R. L. A. 262; Doe v. Northwestern Coal &c. Co. 78 Fed. 62; Newton v. Eagle &c. Co. 76 Fed. 418; Farmers' &c. Co. v. Grape Creek Coal Co. 50 Fed. 481.

The fact that a hotel company owes debts for labor creates no equity for their payment in preference to the bondholders.[58] The further fact that the laborers become riotous, and that much of the corporate property may probably be destroyed or seriously injured but for loans obtained on receivers' certificates, does not show an emergency for the use of receivers' certificates for the preservation of the property. To the state belongs the duty of preserving order, and of repressing and punishing crime; and it was the duty of the receiver to secure the intervention of the public authorities to suppress the threatened riot, and to protect the company's property. While it is difficult to define by rule what expenses for the preservation of the property the court may authorize a receiver to incur, it is clear that there must be something approaching a demonstrable necessity to justify an infringement of the rights of a mortgagee by issuing certificates which shall take precedence of the mortgage lien.[59]

§ 555a. The issue of first lien certificates by receivers is an extraordinary power, to be exercised only in cases of railroads and other like corporations of a *quasi* public character charged with a public duty and for reasons peculiar to that kind of property.[60] Under none of the authorities is a court authorized to displace contract liens upon the property of individuals or private corporations. In a strong opinion by Judge Caldwell,[61] reversing an order authorizing a receiver of an irrigating company to issue certificates to be preferred liens on the property, it is said: "The rights of the citizen lawfully acquired by contract, are under the protection of the Constitution of the United States and are not dependent for their existence or continuance upon the discretion of any court whatever."

Nevertheless it has been declared to be within the power of the court to issue receivers' certificates to pay for completing a railroad,

[58] Metropolitan Trust Co. v. Tonawanda &c. R. Co. 103 N. Y. 245; 8 N. E. 488.

[59] Raht v. Attrill, 106 N. Y. 433; 13 N. E. 282; 60 Am. R. 456.

[60] United States Inv. Co. v. Portland Hospital, 40 Oreg. 523; 64 Pac. 644; 67 Pac. 194; 56 L. R. A. 621; McCornack v. Salem R. Co. 34 Oreg. 543; 56 Pac. 518, 1022; Merriam v. Victory Min. Co. 37 Oreg. 321; 60 Pac. 997; Green v. Coast Line R. Co. 97 Ga. 15; 33 L. R. A. 806; 54 Am. St. 379.

[61] Hanna v. State Trust Co. 70 Fed. 2; 16 C. C. A. 586.

when it is uncompleted at the time of coming into his hands and only partially equipped. Certificates thus issued would, according to this doctrine, take precedence over an outstanding mortgage.[62]

§ 556. Receivers' certificates are subject to the rights of parties having prior liens who have not been brought before the court. Such lien-holders are entitled to contest the necessity, validity, effect, and amount of such certificates after they have been issued, in the same manner as they might if such questions were then first presented, and the court must then declare such certificates to be superior or subordinate to such prior liens, as equity may require.[63]

Receivers' certificates representing indebtedness incurred by order of the court are entitled to priority of payment over certificates issued for preferential debts of the company. When debts of a receiver are contracted in pursuance of an order of the court, the credit is given to the court. Preferential debts contracted by a railroad company on its own credit do not rank on the same high plane with debts contracted by the court on its credit.[64]

[62] First Nat. Bank v. Ewing, 103 Fed. 168.

[63] Hervey v. Illinois &c. R. Co. 28 Fed. 169, 176. Mr. Justice Harlan, delivering the opinion, said: "While the court, under some circumstances, and for some purposes, and in advance of the prior lien-holders being made parties, may have jurisdiction to charge the property with the amount of receivers' certificates issued by its authority, it cannot, without giving such parties their day in court, deprive them of their priority of lien. When such prior lien-holders are brought before the court they become entitled, upon the plainest principles of justice and equity, to contest the necessity, validity, effect, and amount of all such certificates, as fully as if such questions were then for the first time presented for determination. If it appears that they ought not to have been made a charge upon the property superior to the lien created by the mortgages, then the contract rights of the prior lien-holders must be protected. On the other hand, if it appears that the court did what ought to have been done, even had the trustee and the bond-holders been before it at the time the certificates were authorized to be issued, the property should not be relieved from the charge made upon it for its protection and preservation." Affirmed in Union Trust Co. v. Illinois R. Co. 117 U. S. 434; 6 Sup. Ct. 809. To same effect, see Belknap Sav. Bank v. Lamar &c. Co. 28 Colo. 326; 64 Pac. 212; Osborne v. Big Stone Gap Co. 96 Va. 58; 30 S. E. 446.

[64] Bank of Commerce v. Central C. & C. Co. 115 Fed. 878.

§ 557. **A receiver contracting debts under a consent order merely acts as the agent of the consenting bondholders,** and the debts so contracted are not binding upon bondholders who refused their consent. Thus, where an extension of a road was built by a receiver under an order consented to by a part only of the bondholders, without a reference, and the extension was pledged for the cost of its construction, it was held that the lien for building the extension was good as against the consenting bondholders. The mortgage lien, however, covered this extension as after-acquired property subject to such lien for the building of it, and the entire property, including the extension, having been sold under the mortgage, it was held that a bondholder who had refused his consent to the extension, and whose interest was expressly excepted in the consent order, was entitled to his full share of the whole proceeds of sale under the mortgage, without reference to the lien for building the extension.[65]

§ 558. **The courts may place the burden of doubtful expenditures upon the bondholders who ask for them** by directing that the certificates shall not be a charge upon the interest, nor affect the lien of the non-consenting bond and lien-holders. Authority to issue certificates under such a restriction may be accompanied by a reservation to the consenting bondholders of the right at a future time to move to enlarge the order so as to charge also the non-consenting bond and lien-holders, with the understanding that the showing must be so strong as to make it quite clear to the court that the salable value of the road is so increased by the improvements and betterments as to make it equitable to require the non-consenting bond and lien-holders to pay their ratable proportion of the cost.[66]

§ 559. **The court cannot, by authorizing a receiver to create liens upon the property, displace or impair the mortgagee's rights of property,** any more than the legislature can impair the obligation of a contract. The court has power while in possession of property to protect it from loss and destruction, and to preserve it in the condition in which it was received; and for this purpose it may au-

[65] Hand v. Savannah &c. R. Co. 17 S. C. 219.

[66] Investment Co. v. Ohio &c. R. Co. 36 Fed. 48.

thorize the expenditure from the income of the property of whatever is absolutely necessary for its preservation; and may do this as against any and all parties interested. The extent of this power is measured by the absolute necessity of the expenditure for the protection of the property of which the court has taken charge.[67] This expenditure is a matter of duty with the court, and not a matter of discretion. When the limit of such actual necessity is passed, the consent, express or implied, of those whose right of property will be affected, must be had. If large expenditures are to be made to put a railroad into condition to be operated by a receiver, if a new road is to be built, or a part of the existing road is to be rebuilt, or if new rolling stock is to be purchased for it, the debts incurred for these purposes should have the sanction of the mortgagees of the property. If such mortgagees are not parties to the suit in which the receiver was appointed, they should be summoned in before the granting of any petition to charge the property with such debts.[68] When prior mortgagees do not assent to receivers' liens, these should be made expressly subject to the prior mortgages.[69]

The building of a considerable extension of a railroad by a receiver can only be authorized under some peculiar exigency under which such extension is necessary in order to protect the mortgage bondholders and others having interests in the property. Undoubtedly the court might authorize such an extension with the consent of such bondholders, or in a proceeding to which the bondholders or their representatives were made parties. But certificates for such a purpose issued without the consent, express or implied, of such bondholders, would not displace their prior lien under the mortgage.[70]

§ 560. Receiver's debts, and claims against him for services, sup-

[67] Hand v. Savannah &c. R. Co. 17 S. Car. 219, 270, per McGowan, J., quoting text; Metropolitan Trust Co. v. Tonawanda &c. R. Co. 103 N. Y. 245, 249; 8 N. E. 488, per Danforth, J.; Hooper v. Central Trust Co. 81 Md. 559, 591; 32 Atl. 505; 29 L. R. A. 262.

[68] See Regent's Canal Iron Works Co. in re, L. R. 3 Ch. D. 411; stated in § 572; and see article 13 Am. Law Rev. 40, October, 1878, on "Postponing Priorities of First Mortgage Liens," by Judge Clayton.

[69] As was done United States Rolling Stock Co. in re, 55 How. Pr. (N. Y.) 286.

[70] Snow v. Winslow, 54 Iowa, 200; 6 N. W. 191.

plies, and the expenses of management, cannot ordinarily be paid out of the proceeds of the mortgaged property, when this is insufficient to pay the mortgage debt. The mortgage is a lien upon the property itself; but without special provision, it is no lien upon the income. A receiver may pay the necessary expenses of running the road, including damages to persons and property inflicted in the course of the business of the road, out of the income in his hands, which may be called the receiver's fund. There are cases where the court will declare an equity on account of additions made to the value of the mortgaged property through labor done or supplies furnished. "But it seems to us, as a general rule," say the Supreme Court of South Carolina, "that this equity must be limited to the existence of income. The very fact that it is thought necessary to invoke the doctrine of *diversion* shows that in this respect there is a difference between 'income' and '*corpus*.' As the mortgagor himself could not contract debts to displace liens upon the *corpus*, it is not clearly perceived how the court can give that effect to debts contracted by the receiver, who has nothing whatever to do with the finances of the company except the money which arises from the income. Possibly the court might do so in an extraordinary case, where it clearly appeared that the debt was contracted at the instance of the mortgagees and for their benefit, but not in an ordinary case of excess of expenditures over income, without express authority to contract debts upon the faith of the property."[71]

§ 561. The court cannot authorize receivers' certificates for the payment of labor and services in operating the road prior to their appointment, and make them a lien prior to the mortgage.[72] The argument that the value of the mortgage lien has been enhanced by such labor cannot avail to support such a priority to those who hold the position of general creditors. There may be an equity in favor of laborers for services rendered within a limited time before the appointment of a receiver to be paid out of income in the receiver's hands; but in no case can a general creditor, however meritorious the

[71] Hand v. Savannah &c. R. Co. 17 S. C. 219, 270. See, also, Carolina Nat. Bank, ex parte, 18 S. C. 289.

[72] See §§ 607, 609.

consideration of his claim, be given a priority over a lien contracted for and in force when his debt was created.[73]

A receiver appointed under a statute to enforce a statutory lien in favor of a state has no power to contract debts to be paid otherwise than out of the earnings of the road.[74]

§ 562. When receivers' certificates are issued on orders made without prior notice to mortgage trustees or bondholders, the receiver and those who loan money to him on such certificates take the risk of such action as the court may finally take in regard to the loans. It is open to such trustees or bondholders at any subsequent time to contest such certificates when it is attempted to give them priority over their mortgage security.[75]

In such case the approval of the orders by the mortgage trustee, in common with others, acting in his capacity of a director and stockholder, does not estop the bondholders from obtaining a review of the order.[76]

The lien of the certificates continues as long as the order authorizing their issuance remains in force. A reference to determine claims against the receiver, followed by a report which makes no mention of them, is not an adjudication against them when it appears that they were not presented or considered.[77]

An order directing repairs to be made and the issuing of certificates of indebtedness can only be made upon motion and after a proper investigation and hearing.[78]

§ 563. Neither the mortgagor nor his assignees can question the priority of receivers' certificates. In a recent case before the

[73] Metropolitan Trust Co. v. Tonawanda &c. R. Co. 103 N. Y. 245; 8 N. E. 488, reversing 40 Hun (N. Y.) 80 Priority is now given in New York by statute to claims for wages. Laws 1885, ch. 376.

See, also, Hand v. Savannah &c. R. Co. 17 S. C. 219, 270.

[74] State v. Edgefield &c. R. Co. 6 Lea (Tenn.) 353.

[75] Union Trust Co. v. Illinois R. Co. 117 U. S. 434, 456; 6 Sup. Ct. 809; Raht v. Attrill, 106 N. Y. 423; 13 N. E. 282; 60 Am. R. 456.

[76] Raht v. Attrill, 106 N. Y. 423; 13 N. E. 282; 60 Am. R. 456.

[77] Mercantile Trust Co. v. Kanawha &c. R. Co. 50 Fed. 874.

[78] Mitchell, ex parte, 12 S. C. 83.

Supreme Court of the United States,[79] it appeared that the Lake Superior Ship Canal, Railroad and Iron Company, after executing two mortgages of its property, including a large land grant from the United States, made default in the payment of interest, and a receiver was appointed. The receiver, in order to obtain money necessary for completing the canal, and to save the land grant, obtained an order of court authorizing him to create and sell certificates of indebtedness to the amount of $500,000, secured by a mortgage of all the property, which was to be prior in right to all other mortgages. The creditors secured by the existing mortgages appear not to have asked for this order, but they were all there in court and did not object to it. The company afterwards having gone into bankruptcy, the assignees were made parties to the foreclosure suit, and objected to the priority accorded by the decree of foreclosure to the certificates issued by the receiver. But the court held that neither the mortgagor nor his assignee in bankruptcy could object to the order in which the priority of valid and subsisting liens on the premises is fixed by the decree. It could make no difference to them whether the certificates are paid before other liens are discharged, or after all the debts secured by mortgage have been satisfied. The assignees can take nothing until all liens on the assigned property have been removed. "It would be superfluous," said Mr. Justice Strong, delivering the judgment of the court, "to spend much time in considering the power of the court to confer the authority upon its receiver that it attempted to confer. As a court of equity, having the mortgaged property in charge, it was its plain duty to preserve it, not only for the benefit of the lien creditors, but also for the benefit of the company whose possession the court had displaced. Under the provisions of the acts of Congress, granting the lands covered by the mortgages, the lands reverted to the United States, unless the ship canal should be finished within a fixed period, and that period was passing away when the order was granted to the receiver to raise money for completing the canal, by the issue of certificates secured by his mortgage. The canal was unfinished, and there were in the receiver's hands no funds to finish it. Hence, there was a necessity for making the order which the court made,—a necessity attending the administration of the trust the court had undertaken. The order was necessary alike for

[79] Jerome v. McCarter, 94 U. S. 734.

the lien creditors and for the mortgagors; whether the action of the court could make the receiver's mortgage superior in right to the mortgages which existed when it was made, it is hopeless to inquire. None of the creditors secured by those other mortgages objected to the order when it was made, though they were all then in court. None of them object to its lien or its priority now. And we think the appellants, either as representatives of their assignors or of general creditors, cannot be heard to object. Beyond doubt, they would not be entitled to a return of the property discharged from liability for the receiver's certificates remaining unpaid, even if all the other mortgages were satisfied. As against them the certificates are certainly charges upon the property, and they have, therefore, no right to complain of the decree, which gives the certificates priority to other liens."

§ 564. **Provision is made by statute in a few states** that receivers may be authorized to borrow money and create liens upon the property. Thus in Vermont[80] it is provided that the court of chancery shall have power to authorize the receivers or managers of property in the course of administration in such court, when the interest of the parties or property shall require it, to borrow money as it may be needful for the proper and convenient discharge of their duties, at a rate not exceeding eight per cent., and on such other terms, conditions, limitations, and security as shall to the court seem fit. But it is provided that nothing contained in this act shall be construed to prevent such receivers or managers from borrowing money for temporary purposes in the same manner they could before the passage of this act.

In New Jersey[81] the receiver of an insolvent railroad company is empowered to operate the road for the use of the public, and all expenses incident to the operation of such road are declared to be a first lien on the receipts, to be paid before any other incumbrance whatever.

In Ohio[82] it is provided that the earnings of a railroad in the hands

[80] Gen. Stat. 1870, p. 924; Acts 1866, No. 41, page 53.

[81] 1 R. S. 1877, p. 196, § 106; Laws 1874, p. 11.

[82] Laws 1872, p. 31, §§ 1, 3, 4.

of a receiver, and all other moneys coming into his hands as such receiver, shall be applied first to pay costs and expenses of the suit in which he was appointed, and the expenses of operating and managing the road, including all materials and supplies procured by him therefor, and also liabilities incurred by him in such operation and management; and that all judgments recovered against the receiver of a railroad for injuries to person or property, or for wages of employes, or work done, or materials furnished while such receiver is operating or managing such railroad, shall be a lien on the funds in his hands as receiver, but shall affect him only in his trust capacity, and not individually.

When the line of railroad operated by a receiver lies wholly within the State of Ohio, all moneys coming into the hands of the receiver, whether arising from the operating of the road or otherwise, shall be kept and deposited in such place within this state as the court may direct, until properly disbursed; but if any portion of said railroad shall lie in another state or states, then said receiver shall be required to deposit in this state at least such share of the funds in his hands as is proportioned to the value of the property of said road within the limits of Ohio.

§ 564a. Receivers' certificates cannot be enforced in a separate proceeding. Thus, where certificates had been issued in a federal receivership and declared a first lien upon the property, it was held that a purchaser of such securities could not institute proceedings in a state court to enforce his lien, but must wait till final orders were made in the receivership case, directing the payment of his claim.[83]

III. *Negotiability of Receivers' Certificates.*

§ 565. Such certificates, however, are not commercial paper, good in the hands of a *bona fide* holder, without regard to any irregularity or infirmity attending their original issue. They must be governed according to the authority conferred upon the receiver to issue them, and not according to the form which he may choose to

[83] Passage v. Dansville &c. R. Co. 41 App. Div. (N. Y.) 182; 58 N. Y. S. 770.

give them.[84] Thus, where a receiver is authorized to issue certificates to a certain amount, the proceeds to be used in operating the road, an issue of certificates in excess of the amount ordered is beyond the receiver's power, and such certificates are void even in the hands of an innocent holder;[85] or if the receivers use and dispose of the certificates in a manner not in accordance with the order of court authorizing their issue, they are invalid and of no effect in the hands of all subsequent takers, whether *bona fide* holders for value or not.[86]

Where receivers were authorized to dispose of such certificates, payable ten years after date, for not less than ninety cents on the dollar of their par value, and at a rate of interest not exceeding eight per cent. per annum, and they hypothecated them at an exorbitant rate of interest, and received only a third, or, at most, half of the par value of the certificates, it was held that the certificates were good in the hands of the holders of them for the amount of money actually advanced upon them, with interest according to the terms of the order of the court under which they were issued; but that the lenders of the money were not bound to see that the money was applied to the purposes of the trust. The money they have actually advanced cannot be confiscated, because the officers appointed by the court have been unfaithful to their trust.[87] The certificates in this case were made payable to bearer, but on their face they recited that they were made in pursuance of an order of Judge Bradley, on the twenty-sixth day of August, 1872, in a suit in equity pending in the Circuit Court of the United States at Mobile for the District of Alabama, in the Fifth Judicial Circuit, between parties named. The evidence showed that the money was advanced upon the notes of the receivers, the certificates being pledged as collateral, with power to sell them at public or private sale without notice. But the court held that the lenders of money on the hypothecated certificates might be compelled to allow their money to go on the terms prescribed by the orders of the court, both as to the rate of interest and the time

[84] Turner v. Peoria &c. R. Co. 95 Ill. 134; 35 Am. R. 144; Union Trust Co. v. Chicago &c. R. Co. 7 Fed. 513; Central Nat. Bank v. Hazard, 30 Fed. 484.

[85] Newbold v. Peoria &c. R. Co. 5 Bradw. (Ill.) 367.

[86] Stanton v. Alabama &c. R. Co. 31 Fed. 585.

[87] Stanton v. Alabama &c. R. Co. 2 Woods (U. S.) 506.

of payment, and ordered that the certificates not necessary at ninety cents on the dollar, to secure the sums so advanced, should be returned to the receivers.

A subsequent *bona fide* holder of certificates so issued will be protected only to the amount actually advanced by the first purchaser.[88]

§ 566. Certificates issued without consideration are invalid even in the hands of an innocent holder for value.[89] Under a contract for the purchase of iron rails, a receiver issued certificates therefor, which recited the order of court, and were made payable to bearer. The rails were never delivered or tendered to the receiver, but the certificates were transferred to an innocent holder for value. In a suit by him it was adjudged that he could not recover; that the receiver had no powers except those derived from the order of court authorizing the issuing of the certificates, and therefore could issue certificates only "for money borrowed, material furnished, labor performed, or on account of contracts made by him for or on account of the construction or completion of said road or any part thereof."[90] In the language of the court, "When the material was furnished or labor performed he was authorized to issue the certificates in payment therefor, and not until then. And if he made a contract for the construction of the road, he might issue certificates as the material was furnished or the labor performed, and on the completion of the road he could issue his certificates in final payment. But the power is not conferred to issue certificates in payment for material not furnished or labor not performed. On the contrary, we are of the opinion that it fairly appears he was prohibited from so doing. If the necessity existed for enlarged powers, they should have been applied for." Moreover, the certificates referred on their face to the order of court under which they were issued, and the holder was bound to take notice of the limitation of the receiver's power, and bound to know whether the certificates in question were issued in accordance with the power conferred.

[88] Central Nat. Bank v. Hazard, 30 Fed. 484. See § 684.

[89] Turner v. Peoria &c. R. Co. 95 Ill. 134; 35 Am. R. 144; Bank of Montreal v. Chicago &c. R. Co. 48 Iowa, 518; Union Trust Co. v. Chicago &c. R. Co. 7 Fed. 513.

[90] Bank of Montreal v. Chicago &c. R. Co. 48 Iowa, 518; 7 Cent. L. J. 267; 6 Reporter, 616.

It has been declared to be an uncontroverted principle of law that in order to hold the body of a trust liable for receivers' certificates, the proceeds from the sale of such certificates must come to the hands, custody, or control of the receiver.[91]

[91] Alabama Iron & R. Co. v. Anniston &c. Co. 57 Fed. 25.

CHAPTER XVII.

DEBTS OF MORTGAGE TRUSTEES IN POSSESSION.

I. Right of trustees to repayment of their debts and expenses out of the trust fund, §§ 567–577.

II. Liability of trustees operating a railroad as common carriers, § 578.

I. *Right of Trustees to Repayment of their Debts and Expenses out of the Trust Fund.*

§ 567. **Trustees under corporate mortgages have an inherent equitable right to be reimbursed all expenses reasonably incurred** in the execution of the trust, and for such expenses they have a lien upon the trust property.[1] Their rights go even further than this; for, if the trust property prove insufficient to reimburse the trustees for their proper expenses and reasonable compensation, they may call upon the bondholders in whose behalf the trust was created to pay them. It is immaterial that the deed of trust makes no provision for the payment of such expenses and charges; this is a legal right, which necessarily attends the administration of the trust. The franchise and property conveyed to the trustees become charged with a lien in their favor, and they remain so charged until the trustees themselves do something that operates as a discharge of such lien. If, after long litigation by the trustees to establish the mortgage lien,

[1] Rennselaer &c. R. Co. v. Miller, 47 Vt. 146; Morison v. Morison, 7 De G. M. & G. 214; McLane v. Placerville &c. R. Co. 66 Cal. 606; 6 Pac. 748; Mersick v. Hartford &c. R. Co. 76 Conn. 11; 55 Atl. 664; 100 Am. St. 977.

and to enforce it by foreclosure, subsequent mortgagees buy up the bonds secured by the mortgage, and form a new corporation, instead of redeeming the first mortgage by paying the amount fixed by the decree of foreclosure, the right of the trustees to hold all the lien originally existing in them for their services and expenses in administering the trust is nowise affected. Decree of foreclosure, in such case, would have full effect upon the title, as between mortgagor and mortgagee; and, although all the bondholders have been satisfied, the legal title is in the trustees; and if the new corporation, or the subsequent mortgagees, would prevent the trustees asserting their title, and entering into possession, they must satisfy the proper claims they have upon the property. Their lien upon the property extends not merely to claims for their own services, and for payments actually made by them, but to advances made to them by bondholders to supply them with funds in the course of the administration of the trust; for such advances are, in effect, loans to the trustees for the benefit of the trust.[2]

§ 568. **When the object of a receivership has been accomplished, and the occasion for it no longer exists, but it is nevertheless continued, in form and name,** by consent of the parties in interest, the managing party is not regarded as a receiver in the sense of the law, but as having the character and office of an administrator of a trust, by agreement of the parties. Consequently, the debts contracted by such manager, although having the formal sanction of the court, cannot be established as receivership liens, but are debts which are a lien upon the trust property, under the common doctrine that disbursements and expenses, properly made and incurred by trustees, on account of the trust property, are entitled to payment out of the trust property. A decree entered by consent, after the occasion for the receivership has ceased, for a new and continuing system of tenure and management, does not make the manager the officer and representative of the court, but merely the agent and representative of the parties.[3]

§ 569. **These points are forcibly illustrated by the case of the**

[2] Rennselaer &c. R. Co. v. Miller, 47 Vt. 146.

[3] Hand v. Savannah &c. R. Co. 17 S. C. 219, 275, quoting text.

Vermont Central Railroad Company.[4] In the year 1849, the Vermont and Canada Railroad Company leased to the Vermont Central Railroad Company its road and all its property, to hold under a perpetual lease, reserving as rent eight per cent. upon the cost of its road and property, payable semi-annually. In the following year an addition was made to the lease, providing that, after four months' default in payment of the rent, the Vermont and Canada Railroad Company might take possession of both roads, and all the property of both, and run them till, out of the net income, the accrued rent should be paid; and then possession should be surrendered to and resumed by the Vermont Central Railroad Company, and held and used under the original lease. In 1851 the Vermont Central Railroad Company executed a first mortgage of its road, and on the twentieth day of May, in the following year, a second mortgage; but both mortgages were made subject to the rights of the Vermont and Canada Railroad Company under the lease. On the twenty-eighth day of the following June, the Vermont Central Railroad Company surrendered to the first mortgage trustees, who then took possession, and the company has never since had possession. The last payment of rent under the lease was made on the first day of June, 1854. The following year the Vermont and Canada Railroad Company filed a bill in the Court of Chancery in Franklin County against the Vermont Central Railroad Company, and the trustees under both mortgages, and obtained the appointment of temporary receivers; and after protracted litigation the Supreme Court, in January, 1861, issued its mandate to the Court of Chancery, directing that the receivers then in possession, or such as the court might see fit to appoint, should continue in the possession and management of the roads, and secure the tolls and income thereof, and cause the same to be paid over in extinguishment of the rents then due, or which might become due, until the same should be fully satisfied. The Court of Chancery entered a decree accordingly, continuing the receivers in the management of the property, and directing them to pay over semi-annually, on the first days of December and June, such sums as might accrue from the earnings of the property, until the sums then due and growing due for rent should be fully paid.

[4] Vermont &c. R. Co. v. Vermont Central R. Co., decided October 30, 1877, 50 Vt. 500; reported in 14 Am. Railw. R. 497–575.

Under this mandate and decree the receivership was administered until 1864, when a compromise decree was entered in the Court of Chancery, by agreement of the parties.

By this compromise the construction account of the Vermont and Canada Railroad Company was settled; and under the authority of an act of the legislature the back rent was converted into stock, and the capital stock was increased to $2,000,000. To carry this adjustment into effect a decree was entered January nineteenth, 1864, declaring the capital stock of the Vermont and Canada Railroad Company to be $2,000,000, which should be the basis for the computation of the rents provided for in the original lease, to be paid by the trustees and receivers from the income of the roads, in semi-annual payments, beginning on the first day of June, 1864. The decree further provided for a board, to be chosen annually by the stockholders, to advise the trustees and receivers in respect to the management of the roads and property, and to audit the accounts. This decree was manifestly one of consent.

In 1865, upon the petition of the receivers, the court authorized them to borrow $700,000, and to pledge equipment of the road as security. This decree was apparently made with the consent of all the parties in interest. In 1867 a further equipment loan of $300,000 was authorized, and also a loan of $500,000, for the payment of interest on the first and second mortgages. In 1869 a third equipment loan was authorized of $500,000. In 1871 a loan of $1,000,000 was authorized; and in 1872 a loan of $2,500,000, part of which was to be applied to retiring the first equipment loan. The decree authorizing the latter loan provided that the notes issued under the decree should constitute a lien and charge upon the trust property under the control of the trustees and managers, and the earnings thereof.

From time to time, during the period of these decrees, there had been sundry decrees and orders, changing and appointing managers, and ratifying contracts of lease with other roads. All these proceedings professed, and were represented to the chancellor, to be amicable, and for the most part to have been devised and agreed upon by leading parties. No one appeared in any instance with protest or objection. No one made question or objection afterwards, till adverse litigation was begun in 1873, by the Vermont and Canada

Company's petitioning for an order for the payment of the overdue rent, and an order for the removal of the managers.

In the mean time, a corporation by the name of the Central Vermont Railroad Company had succeeded to the management of the property as receivers. Finally, in 1876, this company and various individuals filed a petition, setting forth that for fifteen years the Vermont and Canada and the Vermont Central Railroad Companies had been under the administration of the court in this cause by managers appointed by the court; that during such administration large sums of money had been borrowed by the managers, and bonds issued therefor under different decrees, amounting in the whole to about $4,337,000, outstanding, on which was also due about $175,000 of interest in default; that, in addition to this funded debt, there was outstanding also a floating debt of about $2,000,000; that the managers were without money and without credit; and therefore they prayed that these debts might be declared a charge and first lien upon the property of these roads, and that they might be sold, with all their equipments, for the payment of these and other debts. This petition was dismissed by the Chancellor; and, on appeal to the Supreme Court of the state, his decree was affirmed. Mr. Justice Barrett delivered the opinion of the court, reviewing all the proceedings in the case from the time they were commenced in 1861, and fully examining all the legal questions involved.[5] The original receivership was undeniably proper, as it was the only practical remedy for enforcing the security of the Vermont and Canada Company upon the earnings of the two roads for its rent, except putting this company into the possession and management of the roads; and this the court declined to do, for the reason that the management might be such as to render such possession unduly continued. It was supposed that a receivership, interested to have this claim satisfied at the earliest practicable day, so that subsequent rights and interests might be served by the property, would result in the earliest practicable enfranchisement of the property from judicial control, and the final ceasing of the suit.

In what was provided in the compromise decree, as to the possession and management of the property, the court was performing

[5] Oct. 30, 1877. Vermont &c. R. Co. v. Vermont Central R. Co. 50 Vt. 500; 14 Am. Railw. R. 497, 559, 565, 567, 568, 570.

no duty, but merely accorded, *ex gratia,* assent and ratification. It exercised no judicial judgment, and did not put forth the exertion of its prerogative. It is fundamental in any idea of a receivership that the court is to have the active and responsible control of the administration. That was not so in this case; but, on the contrary, the whole course, in general and in detail, was devised and executed by the managers, and their associates and advisers in interest, without any supposition on the part of themselves or of the court that the court had any real office to perform calling into exercise judicial judgment, direction, or control.[6] "The petition cannot be maintained, then, and the prayer thereof granted," said the learned judge, "on grounds and reasons and rules of the law peculiar to a receivership, as it is understood and provided for and warranted by the law. If it were to be assumed that the trust debts, as they are called, including what is called the floating debt, would be a first lien on all the property, if incurred in the administration of a proper receivership, and that it would be the province and duty of the court to order the sale of the property, as the only means of giving effect to that lien, in rightful satisfaction of such debts, it would not follow that such is true in the case as it is before us. . . . In the other cases of receiverships, where allowances were upheld, the expenditures and services were in receiverships of necessity, and where the expenditures and services were in the administration of the office, under the active and affirmative direction of the court. The other citations point to the common doctrine of the lien of trustees for the proper expenses and disbursements of administering the trust. . . . It can make no difference whether that debt is due to outside parties, or to the parties managing. It is equally on the credit of the trust. The fact that it is without specific security does not give it a higher rank or a different right from debts with security. It stands upon the credit which induced the contracting of it, namely, the promise of the managing party in view of ability and means for payment, just as the secured debts stand on the same credit and the security provided. What is now claimed is, that that debt shall have precedence of the other trust debts, making it first in right as to means of payment, even to the appropriation of the security pledged for the payment of the other debts. There would be no warrant

[6] See Hand v. Savannah &c. R. Co. 17 S. Car. 219, 275, quoting text.

for this, even in case of a proper receivership. The trust is the debtor to each and all its creditors. In the settlement of estates of deceased debtors, the statute gives priority to doctors' bills, and other expenses of the last sickness, and funeral charges. But we know of no statute or rule of law that would warrant the priority claimed in this case. . . .

"In view of that relation, is there any warrant of law for ordering a sale of the property? No case and no book has been presented or come to our notice in which it has been propounded or held that, in a real receivership for managing property, to realize profits by use, and not with a view to its ultimate sale, and the realization of money assets thereby, the property has been or should be sold to realize means for paying charges incurred in the management. The cases are numerous of sales by receivers under the order of the Court of Chancery. But no case is found in which such sale has been ordered as a means of reimbursing receivership expenses, in virtue of a lien in that behalf. . . . If it were to be now held that the property itself in the hands of the Central Vermont Railroad Company is subject to the lien as claimed, such lien would not warrant an order of sale in the first instance. It would be a redeemable lien, resting upon the property in the character of an equitable mortgage; and a sale would be ordered in any event only on failure to redeem, according to the final decree in that behalf."[7]

[7] The facts of the case and the grounds of the decision have thus been stated at considerable length, because the case is a remarkable one in many ways, and in its different phases has been a subject of much controversy, out of court as well as in. It presents many novel and interesting points. The case will be a warning to all bondholders and other creditors of railroad corporations against their allowing either receivers or trustees in the possession of their property to manage it otherwise than to secure its preservation during temporary emergencies. The management in this case resulted favorably, so long as it was confined to the operating of the roads as they were when the receivers were first appointed; but, seeking to secure even better results, the trustees enlarged the field of their operations —they took possession under leases of several other railroads, and of a fleet of steamers on the western lakes. These new enterprises resulted disastrously; and the managers, after obtaining repeated loans, at last found they had incurred, in the management of the property, an indebtedness which the entire value of the roads orig-

§ 570. Debts contracted by trustees in possession for completing the road are preferred to the lien of the mortgage under which the trust arose, when such completion was necessary in order to preserve the value of the franchise. The Hempfield Railroad Company of Pennsylvania issued coupon bonds, and secured them by mortgage to trustees who were authorized by the deed, upon default in payment of the coupons, to take possession of the road for six months, and out of the profits to pay the bondholders. Authority was also given by the deed to the trustees to contract debts for "preserving, repairing, and maintaining" the road. The company by deed delivered possession to the trustees for six months, and afterwards by deed continued the possession until the bonds should be paid. The trustees contracted debts to a large amount for work done and materials furnished, and also completed the road by laying down rails after the road-bed had already been constructed by the company. Upon a subsequent foreclosure sale, a master was appointed by the court to distribute the fund, and he reported in favor of those creditors whose claims had arisen during the trustees' possession, excluding

inally placed in the hands of the receivers might prove inadequate to satisfy. The result is even worse than the improving of a mortgagor out of his security. The receivership was sought by the Vermont and Canada Company, in the year 1855, as a means of obtaining the rent of its own road, which the Vermont Central Company held under a lease. The receivers, in 1861, took possession not only of the road of the latter company, but of the road of the former, by virtue of the lease. In 1877, the creditors to whom were due the debts incurred in the management of the property were before the court, asking for the sale of both roads to pay these debts; and the result may be that not only the mortgage creditors of the Vermont Central Company are improved out of their estate, but that the Vermont and Canada Company, which as creditor sought to collect the rent of its road, has been improved out of its own road as well.

Although there are some cases of improvident management of railroads by trustees and receivers, and others, where they have apparently managed for their own benefit first of all, and in the second place for the mortgagees at whose instance they were appointed, and last of all for those interested in the equity of redemption, yet there are not a few cases where the management of trustees and receivers has been such as to produce profits where no profits had been made before, or to restore profits which corporate officers had failed to keep up.

the bondholders and creditors whose debts had been contracted before the delivery of the road to the trustees under the deed.[8] The bondholders having excepted to the report, Sharswood, J., at *nisi prius,* dismissed the exceptions.

The iron for the rails laid down by the trustees on this road they paid for partly in cash and partly in bonds of the company, subject to redemption at par in one year. The holder of the bonds so issued claimed that they were not taken in payment, but that the right to redeem stamped them as collateral security, and therefore that he was entitled to preference in the payment of the debt as one contracted by the trustees in the performance of their trust. His claim was allowed and charged upon the fund.[9]

The right of the trustee in possession to repayment of his advances and expenses on account of the property takes priority of the mortgage under which he acts, and of the claims of all subsequent creditors. He is the owner of the property at law, and when called upon to account he may deduct out of the trust property whatever sums he had expended or become liable for in the discharge of his trust. His claim is the first charge upon the property.[10]

Trustees for bondholders lawfully in possession of a canal should be allowed to repair it and restore it as a waterway, so as to produce revenue.[11]

§ 571. If mortgage trustees have paid for the protection of the trust property a prior incumbrance, they are subrogated to the lien of that incumbrance as against the company, and are entitled to be reimbursed the amount so paid by them with legal interest. Although the trustees did not purchase such prior incumbrance, or become, technically, the assignees thereof, but paid it, the lien will be regarded, in equity, as subsisting, so far as it is necessary, for their protection.[12]

§ 572. A creditor or other person not holding the position of

[8] Patterson v. Hempfield R. Co. 1 Weekly Notes of Cases, 127.

[9] Exhall Coal Co. in re, 35 Beav. 449.

[10] Patterson v. Hempfield R. Co. 1 Weekly Notes of Cases, 127.

[11] State v. Brown, 73 Md. 484; 21 Atl. 374; The Canal Co.'s Case, 83 Md. 549; 35 Atl. 161, 354, 581.

[12] Memphis &c. R. Co. v. Dow, 120 U. S. 287, 7 Sup. Ct. 482.

trustee has no right to be reimbursed for his advances to protect a corporation in preference to mortgage creditors.—One who does not hold the legal title and does not legally represent the bondholders in his possession and management of the property, but being a creditor and stockholder in a company voluntarily advances money for the payment of wages, rents, and other purposes essential to prevent the immediate sacrifice of the property, has no claim to be repaid in preference to the mortgage bondholders. A company, formed for the purpose of manufacturing iron, mortgaged its property and afterwards borrowed money from one Grissell, the former owner of the works and then a shareholder in the company, under an agreement that all moneys due to the company were to be received by him, and these moneys, and also the money to be advanced by him, were to be applied by him in paying wages and salaries and other outgoings for the business of the company, and finally to the repayment of his advances. Subsequently the company resolved to wind up voluntarily, and an order of court was made for this purpose. Afterwards Grissell and the liquidators, with the sanction of the vice-chancellor, made an agreement for an advance by Grissell of further sums on similar terms. He accordingly made further advances for the payment of rent, wages, taxes, and outgoings. A large balance remained due to him when the liquidators sold the leasehold property, machinery, and plant of the company. Grissell claimed the repayment of his advances in carrying on the business in preference to the debenture holders, and the vice-chancellor allowed the claim as costs of preservation. But on appeal it was held that the fund arising from the sale belonged to the debenture holders in priority to the claims of Grissell or the liquidators for the costs so incurred. The debenture holders were not parties to the agreement with Grissell, and the sanction to the agreement given by the court did not bind them. No debenture holder was summoned before the court, or was asked whether he approved the arrangement. No one represented the debenture holders, and they were not affected by anything that was done.[13] The liquidators claimed priority for their costs, expenses, and remuneration; but the court adjudged that their claim could not be sustained. Lord Justice James, delivering the judgment, said that "no doubt it is a very hard case for them that they

[13] Regent's Canal Iron Works Co. in re, L. R. 3 Ch. D. 411, 426.

have had to deal with an insolvent company, but they ought to have looked into that matter before they incurred expenses and made themselves liable; and that they should not have incurred disbursements which they had no means of reimbursing themselves.

"The debenture holders are the creditors to whom the property belonged; they had a specific right to the property for the purpose of paying their debts. If the property is realized in the proceedings to which they are parties, they must pay the costs of the realization, just as they would have had to pay them if they had their own suit for the purpose of realizing it. No doubt there were costs of preservation, which means that by keeping the thing going for some years the property ultimately realized more for the debenture holders than it would have otherwise realized. But this is merely a surmise, and if true it would really make no difference. The services rendered in that way cannot create a charge against the mortgagee. The only costs for the preservation of the property with which they would be chargeable would be the repairing of the property, paying rates and taxes, which would be necessary to prevent any forfeiture, and the care of the property. The liquidators in this case never paid anything of the kind. The leaseholds, machinery, and plant were never the subject of expenditure on the part of the liquidators."

§ 572a. Money advanced by an outsider to pay taxes is not a preferred claim where the person making the advance is under no obligation to pay them, and it does not appear that he was either requested or authorized to do so by the bondholders. A request by the railroad company is not enough, as it could not by agreement give a lien or claim upon the body of the mortgaged property which would take precedence over that of the bondholders.[14]

§ 573. Compensation of trustees.[15]—It is a general rule that the allowance made by a court to trustees in a railroad mortgage for their services in relation to its foreclosure will be proportioned to

[14] Mersick v. Hartford &c. R. Co. 76 Conn. 11; 55 Atl. 664; 100 Am. St. 977.

[15] On the general subject of the compensation of trustees, see 2 Perry on Trusts, §§ 916–919; and see §§ 527–530.

the amount of services actually required and rendered. The court is not bound to allow a fixed commission on the amount recovered.[16]

The Des Moines Valley Railroad Company executed a mortgage upon its road and lands, which stipulated, among other things, that the holders of any of the mortgage bonds should have the privilege of purchasing any of the lands not required by the company for the necessary or convenient operation of the road at the then minimum price fixed by the company, and to pay therefor in bonds at their par value. The mortgage also stipulated that the proceeds of the sales of lands should constitute a sinking fund for the discharge of the mortgage debt; and that the bondholders should be required to cancel the bonds so taken up, and that for services in selling and conveying the lands, and applying the proceeds to the sinking fund, the trustees should receive two per cent on the amount of the bonds cancelled. Upon a subsequent foreclosure of the mortgage the trustees filed their account, showing that they had cancelled bonds to a very large amount on which they claimed the above named commission. Some of the bondholders appeared and objected to the allowance of two per cent. on the face of the bonds received by them in payment of lands sold, but the Supreme Court of Iowa held that the sale of lands and the payment in bonds was equivalent to a sale for cash, and that therefore the trustees were as much entitled to this commission upon the par value of bonds received in exchange for lands and cancelled as they were upon bonds cancelled upon purchase with the proceeds of cash sales of the lands, the mortgage recognizing no distinction between the modes of payment.[17]

§ 574. **A foreclosure decree rendered in a circuit court fixing the compensation of the trustees is a final decree** in that matter, from which an appeal may be taken. A holder of bonds secured by the mortgage has an interest in the amount of the trustees' compensation which entitles him to intervene and appeal from a decision adverse to his interests.[18]

The trustee is generally entitled to his compensation and to the

[16] Phinizy v. Augusta &c. R. Co. 98 Fed. 776.

[17] Gilman v. Des Moines Valley R. Co. 41 Iowa, 22. See, also, Truesdale v. Farmers' &c. Co. 67 Minn. 454; 70 N. W. 568; 64 Am. St. 430.

[18] Williams v. Morgan, 111 U. S. 684; 4 Sup. Ct. 638.

expenses of the trust and costs of sale, before making any distribution of the proceeds of sale to the bondholders. This preference is usually provided for by the deed of trust.[19]

§ 575. **The funds in the hands of a receiver are chargeable with the retainer and professional services of an attorney employed by the trustees** under a mortgage of a railway to foreclose the mortgage, although the suit, without the fault of the attorney, was not prosecuted with effect, and the funds in the hands of the receiver have been obtained from a new suit, prosecuted by other trustees; as, for instance, where the prosecution of the first suit was prevented by the outbreak of the civil war, and the trustees who authorized the suit having died, new trustees were appointed upon the termination of the war, who commenced a new foreclosure suit.[20]

§ 576. **A bondholder who in good faith files a bill for the common benefit of all the bondholders is entitled to be paid his costs, counsel fees, and necessary expenses** from the fund secured through his efforts, before the distribution of it among the lien-holders. These costs and expenses must be only such as are incurred in the fair prosecution of the suit. The complainant cannot be allowed for his private expenses, such as traveling fares and hotel bills, or for his own time and personal service.[21]

§ 577. **Trustees managing a railroad are not liable for the use and occupation of land outside the location** of the railroad, in the absence of any evidence of a demise, whether the use was by permission of the owner or not. A contract, express or implied, is necessary to sustain the action.[22]

[19] Smith v. Washington City &c. R. Co. 33 Gratt. (Va.) 617; Nickerson v. Atchison &c. R. Co. 3 McCrary (U. S.) 455.

[20] Cowdrey v. Galveston &c. R. Co. 93 U. S. 352; 9 Am. Railw. R. 361. As to extent of attorney's authority to charge expenses of an appeal against upon a trustee, see Pilcher v. Sioux City &c Co. 12 S. Dak. 52; 80 N. W. 151.

[21] Trustees v. Greenough, 105 U. S. 527; Central R. Co. v. Pettus, 113 U. S. 116; 5 Sup. Ct. 387.

[22] Central Mills Co. v. Hart, 124 Mass. 123.

II. *Liability of Trustees operating a Railroad as Common Carriers.*

§ 578. Trustees operating a railroad for the benefit of the bondholders are regarded as owners of the road, so far as to render themselves liable as common carriers for loss or damage to merchandise, or for damages to passengers occasioned by the negligence of their servants and employes. Thus, the trustees of the second mortgage bondholders of the Northern Railroad Company having foreclosed their mortgage by permission of court, purchased the mortgaged property at the sale, and proceeded to operate the road for the benefit of the bondholders. They undertook to transport a large quantity of grain, which was burned on the road. In a suit against them for the loss of the goods, they were held liable as common carriers.[23] The fact that, by the decree authorizing the trustees to purchase at the foreclosure sale, the court undertook to give directions as to the mode of executing the trust in respect to a subsequent sale, and in respect to operating the road, was held not to change the character in which they held the property, and make them receivers of the property. They continued to hold the property as trustees, and as such held the legal title to the property, and received the income and profits of it for the benefit of their *cestuis que trustent*.[24]

The same liability attaches to a mortgage trustee who has entered into possession of a railroad in pursuance of the provisions of the mortgage, or in pursuance of a statute and decree of court, and, before completing a foreclosure, operated the road for the benefit of the bondholders.[25] In Connecticut, by statute, such trustee is declared not to be personally liable for any cause of injury arising from the operation of such road, except for his willful mismanagement, or for any contracts made by him as such trustee; but all the trust property in his charge is liable for the acts and proceedings of such trustee, in the execution of his trust, to the extent of the interest of the creditors, for whose benefit he acts: and any proceedings for the purpose of making such property liable should be brought

[23] Rogers v. Wheeler, 43 N. Y. 598; Barter v. Wheeler, 49 N. H. 9; 6 Am. R. 434; Sprague v. Smith, 29 Vt. 421; 70 Am. Dec. 424.

[24] Barter v. Wheeler, 49 N. H. 9; 6 Am. R. 434.

[25] Lamphear v. Buckingham, 33 Conn. 237.

against such trustee, describing him as such.[26] Under a statute authorizing trustee in possession to apply the income of the road to the payment of the "running and operating expenses of the road," a claim for negligently injuring property at a highway crossing would be properly included.[27]

[26] G. S. 1875, p. 333, § 85; G. S. 1866, p. 196, § 513.

[27] Smith v. Eastern R. Co. 124 Mass. 154.

CHAPTER XVIII.

THE PRIORITY OF RAILROAD MORTGAGES AS AFFECTED BY EQUITIES ARISING SUBSEQUENTLY.

I. Equities of employees, §§ 579–583.
II. Equities of contractors and materialmen, §§ 584–588.
III. Equities of claims for operating expenses, §§ 589–611.
IV. Equities under subsequent contracts and leases, §§ 612–615.

I. *Equities of Employes.*

§ 579. **General Statement.**—At the outset it is proper to state as a general principle, that a fixed legal right under a mortgage cannot be impaired by any equities subsequently arising, except only the equities growing out of claims for operating expenses. Statutes in force at the time of execution of a mortgage may give rights as against the mortgagee to other persons, under claims subsequently arising; but in such case the statute becomes a part of the original mortgage contract. Subsequent legislation could not affect the priority of an existing mortgage. Even Congress cannot limit the tolls of a canal company whose revenues are pledged to secure its bonds, so as to impair the rights of the bondholders. Mr. Justice Miller, construing an act relating to the Louisville and Portland Canal Company, emphatically said: "I have no hesitation in saying that that part of it which so limits the tolls is void, for the plain reason that it is a legislative attempt to destroy vested rights and a taking of private property for public use without due compensation."[1]

[1] United States v. Louisville &c. Co. 4 Dill. (U. S.) 601, 611. Judge Dillon, in a note to this case, says, that in England parliament would

The claims of employes of a railroad, due at the time it is placed in the hands of a receiver, are, in New Jersey, provided for by a statute,[2] which makes them a lien upon all unincumbered personal effects, and all moneys which may be transferred to the receiver at the time of his entering upon his duties, but limits the payments to not more than two months' wages. Under such act, however, the claims of employes are subject to incumbrances upon such property existing when the act was passed. The lien cannot be extended beyond the provisions of the act, which, though it will receive construction, cannot, of course, be so construed as to diminish or impair the obligation or lien of a previous levy of an execution, or of a previous mortgage.[3]

§ 580. **The most reasonable ground upon which a chancery court can order a receiver to pay the wages of employes of a railroad company,** due at the time the road is placed in the receiver's hands, is that the mortgagees, in asking for the appointment of a receiver, are seeking an equitable remedy, and having only an equitable claim to the income in the receiver's hands, the court in granting this remedy may impose such conditions as may seem just. This was the ground taken by the Court of Appeals of Kentucky, in the leading case of Douglass v. Cline.[4] The Louisville, Cincinnati and Lexington Railroad Company executed a mortgage to a trustee, which authorized him, upon default, to take possession of the property, and by himself and agents, or by a receiver of court, to use and operate the road and receive the earnings and income of it, or to have the mortgaged property sold and conveyed under a decree of court. No specific lien was given upon the earnings of the road while held and operated by the company itself. Upon default, the trustee, instead of taking possession of the road himself, obtained the appointment of a receiver. Shortly afterwards the employes of the road, to whom wages were due at the time of the appointment, obtained an order from the vice-chancellor, directing the receiver to pay them the

possess this power as shown by the case of Brown v. London, 9 C. B. (N. S.) 726. See Coe v. New Jersey M. R. Co. 31 N. J. Eq. 105, 131, in connection.

[2] Feb. 12, 1874, Acts 1874, p. 12; 2 Rev. 1877, p. 943, § 161.

[3] Williamson v. New Jersey Southern R. Co. 28 N. J. Eq. 277, 300.

[4] 12 Bush (Ky.) 608. And see Newport & Cincinnati Bridge Co. v. Douglass, 12 Bush (Ky.) 673.

amounts due them out of the net earnings of the road; and this order was sustained upon appeal. The decision of the court had special reference to the nature of a mortgage, as determined by the Code of Procedure of that state, under which the mortgagee, although invested with the legal title, cannot recover possession in an action at law. Having no legal right to recover possession simply by reason of holding the mortgage title, his right of possession must rest upon express contract, or else must be sought in equity. But in this case the trustee, either because the express contract in the mortgage could not be enforced, or because he did not see fit to enforce it, sought his remedy in equity, and obtained the appointment of a receiver. It was then insisted, in behalf of the mortgage bondholders, that inasmuch as it was made to appear to the satisfaction of the chancellor that he ought to take possession of the mortgaged property, he was bound to do so unconditionally, and that he had no discretion as to the application of the fund that might come into the receiver's possession, but was bound, as matter of law, to apply this fund to the extinguishment of the lien debts in the order of their priority. But the court declared that, while the mortgagees had, in equity, a perfect right to have the property protected and preserved while the actions to enforce their mortgages were pending, yet the power of the court to do this through the instrumentality of a receiver is discretionary in its nature; that the right of the mortgagees to have the fund raised by the receiver applied for their security as against the general unsecured creditors of the mortgagor is equitable only, and therefore that the chancellor is not bound to enforce it under all contingencies, but may, in proper cases, attach to its enjoyment reasonable conditions, and may do this either in the order appointing the receiver, or by an order subsequently made.

§ 581. **The court lay stress upon the meritorious character of the claims of the employes**; upon the fact that their services in repairing and operating the road had preserved the property, and enabled the company to retain its business and the public confidence, and therefore had resulted in substantial advantage to the mortgagees, who are insisting that the payment of the employes out of a fund to which they have no legal or contract right, and which they can reach only through the intervention of the chancellor, is an

abuse by that officer of his equitable discretion. It was to the interest of the lien-holders, they say, that the receiver should be enabled, pending the litigation, to operate the roads of the company successfully and profitably. To secure immediate success in this regard, it was desirable, if not indispensably necessary, that he should be enabled to retain in his service the force of employes he found in the service of the company when he took possession of its roads. One of the grounds of the application for a receiver was the discontent upon the part of the employes, resulting from the non-payment of their wages. "It was the duty of the chancellor to allay this discontent, and to assist his receiver in securing the services of these people, and thus insure the profitable management and operation of the roads in his hands, if this could be accomplished by an act manifestly just, certainly within the scope of his judicial powers, and to which the appellants ought not, in good conscience and fair dealing, to object." Moreover, the court declared, it is not strictly accurate to say that the employes bear to the mortgagees the same relation as that borne by other general creditors of the insolvent company.[5]

[5] Douglass v. Cline, 12 Bush (Ky.) 608, 630, 631. "The mortgagees accepted their securities with knowledge that the railroad company, though technically speaking a private corporation, was under obligations to the state to render certain important public services. They knew that the railroads were, in a certain sense, public highways, and that whoever owned them, or held them in pledge, was bound to see that they were at all times so operated as to subserve the public convenience. The interest the public has in the construction and successful operation of lines of railway has influenced the courts to treat railroad mortgagees as possessing rights superior to those of beneficiaries under mortgages covering other kinds of property; and courts of equity have not hesitated to interfere for their protection in cases in which other mortgagees would have been left to their remedy at law. . . . It was through the labor and services of these employees, performed and rendered after the railroad company had become notoriously unable to meet its indebtedness, and during a period when the mortgagees either could not or would not interfere to protect and preserve their mortgage security, that the company's roads were operated and its duties to the public discharged; and, as we have already seen, it was by this labor and these services that the mortgaged property during this period was preserved and kept in repair. It is plain, therefore, that the debts due to the appellees were contracted for labor which resulted in substantial advantage to the

In conclusion, the court remark that it will not necessarily follow from its decision that all the general creditors of the railroad company will be able to assert successfully their right to be paid out of the fund held by the receiver; that each claim must rest upon its own peculiar merits; and that, as the mortgagees have *prima facie* an equitable claim to the whole fund, the *onus* will be upon each general creditor to establish a superior right upon his part.

The general result arrived at in this case is supported by a decision by Judge Wellford, in the Circuit Court of the city of Richmond.[6] The grounds of the decision are that the officers of the insolvent company, having the right of possession, and being allowed by the mortgage creditors to remain in possession long after the company's default had become notorious, might be in some sense regarded as the agents of the mortgagees in operating the road; and that, at any rate, the claims of employes, due at the time the mortgagee obtained the appointment of a receiver, are of such an equitable nature that the court will require them to be satisfied out of the subsequent earnings of the road, or out of the trust property.

Arrears of salary of the president of a railroad will not be paid in preference to a mortgage debt, when the road goes into the hands of the receiver without funds and the earnings barely pay operating expenses.[7]

§ 581a. A claim by a merchant for rations furnished to laborers under contract with the railroad company, and for which the company alone is liable, is not entitled to come in under a preferential order, although the company charges the rations to its laborers as part of their wages, and such wages are given a preference. The preferential order is merely a personal protection, given *ex gratia* to those who depend upon their daily labor for support.[8]

parties who are here insisting that their payment out of a fund to which said parties have no legal or contract claim, and which they can reach only through the intervention of the chancellor, is an abuse by that officer of his equitable discretion."

[6] Duncan v. Chesapeake &c. R. Co. 9 Am. Railw. R. 386.

[7] National Bank v. Carolina &c. R. Co. 63 Fed. 25. See American Lace &c. Works, matter of, 30 App. Div. (N. Y.) 321.

[8] Finance Co. v. Charleston &c. R. Co. 49 Fed. 693.

§ 582. It sometimes happens that mortgage creditors find it a matter of policy to assume the payment of certain general debts of railroad corporations, and to consent to the entry of decrees requiring their receivers to pay such debts out of the receipts of the road or from the proceeds of sales of the mortgaged property.[9] The claims of laborers and employes more frequently than any others are so provided for. Aside from the equitable consideration that their labor has benefited the property, there is the practical consideration that it is generally necessary or at least desirable that the receivers, and after them the purchasers, should continue the operation of the roads by the aid of the services of the same persons. Sometimes mortgage creditors even find it to their advantage to compromise the claims of other general creditors. Delay in obtaining the appointment of receivers, and through them the possession of property, may be avoided; and such delay is a serious matter when a road extends through several states and the aid of the courts of each must be sought and obtained against the active efforts of creditors. Such considerations doubtless led the mortgage creditors of the Atlantic and Great Western Railway Company to consent that the decree appointing a receiver of the road should provide for the payment, out of the net earnings of the road, of claims for materials and supplies and of arrearages owing to the laborers and employes of the company "for labor and services actually done in connection with that company's railways." Under this decree Jeremiah S. Black, Esq., claimed payment of $5,000 for professional services as counsel for the company, rendered prior to the appointment of the receiver. The referee to whom the claim was referred found it to be reasonable in amount, but that the claimant was not included in the class provided for in the order; that the word "employes," as there used, included only those persons who had been in the stated and regular employment of the company. The Supreme Court of New York also took this view of the claim, and disallowed it.[10]

The Court of Appeals, however, reversed this decision and sustained the claim.[11] The claimant was considered an employe who had rendered services in connection with the company's railways

[9] See 4 Cent. L. J. 458, 544.

[10] Gurney v. Atlantic &c. R. Co. 2 Thomp. & C. (N. Y.) 446.

[11] 58 N. Y. 358. See Aikin v. Wasson, 24 N. Y. 482.

within the terms of the order. Whether he should be so regarded or not was a question as to the intent of the order, and it was regarded as more probable, from the terms of the order, that the intent was to include rather than exclude the debt of the claimant. This intent was moreover regarded as established by evidence as to the sense in which the parties used the words, and by the circumstances of the case. Debts for materials and supplies were protected, and why might it not be supposed that the claimant's demand was regarded to be as just and equitable as those, especially under the circumstances referred to? The mortgage creditors by making these concessions, gained what they regarded a great advantage,—the immediate appointment of a receiver; and the order should be liberally construed in favor of the creditors, who are presumed to have assented to it and relied upon it for the payment of their debts.[12]

§ 583. In no case had any one of the federal courts allowed claims for supplies or for labor in preference to existing mortgages when the mortgagees had not consented to such allowance prior to the decision in Fosdick v. Schall.[13] In one case, indeed, after supply claims and other floating debts to the amount of $700,000 had been audited and paid by the receivers with the consent of the parties in interest, objection was finally made to a similar claim of small amount presented at the eleventh hour, when Judge Treat, of the Circuit Court, followed the settled rule of law and rejected the claim.[14] The case of Fosdick v. Schall was decided soon after the first edition of this treatise was published, and from the time of that decision was established a new equity as against mortgages of railroad,—the equity of claims for the operating expenses incurred within a limited time before possession has been taken by a receiver.[15]

[12] Gurney v. Atlantic &c. R. Co. 58 N. Y. 358, per Church, C. J. See § 595.

[13] See § 589.

[14] Ketchum v. Pacific R. Co. 4 Cent. L. J. 458, 459.

[15] It is true that the doctrine had been partially declared in a few earlier cases, as in Douglass v. Cline, § 580, supra, and Duncan v. Chesapeake &c. R. Co. § 581, supra, and substantially in Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 315, per Drummond, J.; but it had not had such full and authoritative statement as to make the doctrine an established one.

II. *Equities of Contractors and Material-Men.*

§ 584. **It has sometimes been sought to establish equities in favor of those who have furnished material or money for building or repairing of railroads,** on the ground that the property has thus been conserved and rendered capable of profitable use. This is, in fact, an attempt to apply to railroads the principle adopted by the civil and maritime laws of awarding priority to the last creditor who furnishes necessary repairs and supplies to a vessel. Thus, in Galveston R. R. v. Cowdrey,[16] a person who had furnished the iron laid upon a portion of the road claimed therefor an equitable lien in preference to an existing mortgage: first, because the mortgage covered the iron only as after-acquired property, and upon the principle of equitable estoppel which should yield when it comes in conflict with a superior equity; and, secondly, because his property applied to the road had rendered it capable of being operated, when it otherwise could not have been used. The Supreme Court of the United States denied the claim on both points, declaring that the mortgage attached to the property as soon as it was acquired, and that the principle of maritime law contended for had no application. Mr. Justice Manning, referring to this case, in giving the decision of the Supreme Court of Alabama, in the recent case of Meyer v. Johnston,[17] with reference to the latter principle, said: "A ship far from home, in distress and without resources, must perish, and perhaps her crew with her, if a bottomry bond given then for repairs and supplies shall not have precedence of other liens upon the vessel. But the court does not consider a railroad on *terra firma* so beyond the reach of help from those who own it, or are concerned in it, as to justify the adoption, in such a case, of the rule relating to a ship abroad, and about to perish."

Accordingly the court, in this case, refused to give precedence to the claim of a contractor for repairing and completing a railroad, although by contract with the company he was to have possession of the property until his claims were paid.

[16] 11 Wall. 459, 480. See Lackawanna &c. Co. v. Farmers' &c. Co. 79 Fed. 202, citing text.

[17] 53 Ala. 237, 247, 345.

§ 585. A mortgage by a railway company of their "road, built and to be built," has precedence, even as regards the unbuilt part, of the claim of a contractor who has himself finished a portion of the road under an agreement that he should retain possession of the road, and apply its earnings to the liquidation of the debt due him, and who has, in accordance with such agreement, taken possession of the road, and retained it. The Supreme Court of the United States so held upon a bill filed for the foreclosure of such a mortgage, which had been duly recorded several months before the contract for building the road was made.[18] Said Mr. Justice Clifford: "All of the bonds, except those subsequently delivered to the contractor, had long before that time been issued, and were in the hands of innocent holders. The contractor, under the circumstances, could acquire no greater interest in the road than was held by the company. He did not exact any formal conveyance; but, if he had, and one had been executed and delivered, the rule would be the same. Registry of the first mortgage was notice to all the world of the lien of the complainant; and, in that point of view, the case does not even show a hardship upon the contractor, as he must have known, when he accepted the agreement, that he took the road subject to the rights of the bondholders. Acting as he did, with a full knowledge of all the circumstances, he has no right to complain if his agreement is less remunerative than it would have been if the bondholders had joined with the company in making the contract. No effort appears to have been made to induce them to become a party to the agreement, and it is now too late to remedy the oversight. Conceding the general rules of law to be as here laid down, still an attempt is made by the respondents to maintain that railroad mortgages made to secure the payment of bonds, issued for the purpose of realizing means with which to construct the road, stand upon a different footing from the ordinary mortgages to which such general rules of law are usually applied." But the court say that, although some authorities seem to favor the supposed distinction, the argument, in their view, is not sound, and the weight of judicial determination is greatly the other way.

§ 586. The order of priority of two or more railway mortgages

[18] Dunham v. Cincinnati &c. R. Co. 1 Wall. (U. S.) 254, 267.

is not affected by the fact that a part of the road was wholly built by money raised by means of the junior mortgage. The giving of priority to the last creditor is a rule which is applicable only to marine cases, which stand on a particular reason. The rule, *Qui prior est tempore, potior est jure,* governs as to the priority of mortgages at common law.[19] In a recent case before the Supreme Court of Alabama,[20] an attempt was made to reverse the order of priority of mortgages, upon the ground that the prior bondholders could equitably claim only the value of the railroad and its appurtenances in the condition they were in before the road was reconstructed and completed by capital furnished for that purpose under a subsequent mortgage. It was urged that, if this expenditure had not been made, a court of equity would have authorized a lien upon the property for the purpose of making it available; and, therefore, the court should not hesitate to approve and ratify what had been done voluntarily, and to protect those who had furnished money for the preservation and life of the road. But the court regarded it as well settled that a prior mortgagee could not be divested of his lien in this way; and that a junior mortgage could not, by force of any lien for repairs, be given precedence of a senior one.

A junior mortgagee has no more right than the mortgagor himself to charge for repairs and improvements made upon the mortgaged property. The mortgagor not having this right, he can confer no such right upon a junior mortgagee, as against a prior mortgagee. Expenditures made by a junior mortgagee stand, in this respect, upon the same basis as when made by the mortgagor: they confer no equity whatever as against prior incumbrances.

§ 587. A claim for materials furnished an insolvent railway company, which is not a lien by virtue of any statute, is not entitled to payment out of the funds arising from a sale of the property at the instance of prior mortgage bondholders, until the bonds are paid.[21] A promise by the receiver to make such payment does not change the case. The ground of the application in this case was that the supplies were furnished to the road while it was run by a lessee, and

[19] Galveston R. Co. v. Cowdrey, 11 Wall. (U. S.) 459, 482.

[20] Meyer v. Johnston, 53 Ala. 237.

[21] Denniston v. Chicago &c. R. Co. 4 Biss. (U. S.) 414.

that when the road came into the hands of the receiver, the parties who had furnished the supplies had an equitable lien upon the funds realized from the earnings of the road. They had no specific lien, legal or equitable, upon the property. The facts of the case were that there were large mortgages upon the road, and the company had become hopelessly insolvent. Application was made to the court to put it into the hands of a receiver, in order that it might be operated for the payment of these mortgages. This was done, and the road remained in the hands of the receiver for some years. Subsequently other creditors applied to the court, it being manifest that the mortgages could not be paid in that way, or at any rate, that the time would be so long that it was desirable for the interests of all that the administration of the road should be changed; and a sale of the property was ordered and made, so that the parties in interest might realize upon their claims. The court held that the petitioners had no equitable lien upon the proceeds of the sale, because the prior mortgage liens must prevail, and these would sweep away the entire fund, and would then be only paid in part. Judge Drummond, in making this decision, said, by way of illustration: "It is precisely like the case of a man who furnishes to the owner of a farm the means of carrying it on; but there is another party who has a lien upon that farm, and it is sold in order that the party who has the prior lien may be paid. Now, the fact that the mechanic or laborer has furnished the means of carrying on the farm would not authorize him to come into a court of equity and cut off the prior lien which exists on the farm, and prevent it from being paid. These parties ought to be paid. They have a just claim against this road. But it is against an insolvent corporation, and they ask parties who have a prior right and lien to pay them, because those with whom they have dealt cannot do so."

§ 588. Advances made to pay for rolling stock.—The president and directors of the New Jersey Midland Railway Company, previous to its insolvency, advanced money to pay for rolling stock leased to the company, to be paid for by monthly instalments, and to remain the property of the vendors until the whole amount of the purchase money should be paid. They did this to preserve the property for the benefit of the company and its creditors, and with the under-

standing on their part that, upon the payment of the balance due upon the rolling stock, they should become the owners of it. Upon the appointment of a receiver in a foreclosure suit, they petitioned the court that they might be subrogated to the rights of the vendors of the rolling stock to the extent of the advance made by them on account of it, and that the receivers should be ordered to pay to them the amount so advanced, with interest.[22] The court, however, denied the petition, because there could be no subrogation without an express agreement for the right, either with the debtor or the creditor; and because the right could not be enforced until the whole debt was paid. Moreover, the advances were made, and the petitioners' rights accrued, long before the filing of the bill in the foreclosure suit. The payment of these claims by the receivers was nowise necessary for the preservation of the property, or the protection of the mortgagees or other creditors. The petitioners stood in a different position from the owners of the rolling stock. They had no power to embarrass the receivers by removing the property. The court, therefore, declined to consider their claim until, upon a hearing of the cause, the rights and priorities of all parties claiming liens upon the mortgaged premises could be settled and adjusted.

One who has loaned money to a railway company, to enable it to pay interest on its coupon bonds, has no equity entitling him to be paid out of funds in the hands of a receiver of the road appointed in behalf of the bondholders.[23] A loan, however, made for this

[22] New Jersey &c. R. Co. v. Wortendyke, 27 N. J. Eq. 658. "The duties of a receiver in a foreclosure suit," say the court, "are in aid of the mortgagee, by collecting the rents and preserving the property from loss and decay. In railway foreclosures, his duties, though more extensive, are primarily the same. The appointment is presumed to be for the benefit of the mortgagees, and for the protection of their interests. In this case it is claimed that the mortgage covers the rolling stock, and that upon full and final payment by the company, or by the receivers, to the owners of the stock, the title will vest in the company, or their mortgagees, and enure to the benefit of the bondholders. The petitioners seek, at this early stage of the foreclosure suit, and in this irregular mode, to enforce a lien alleged by them to be superior or prior to that of the mortgagees. In this view, it is simply a contest for priority between parties claiming liens upon the mortgaged premises."

[23] Newport &c. Co. v. Douglass, 12 Bush (Ky.) 673, 714.

purpose, upon the agreement or understanding that the lender should be treated as the assignee of the holders of the coupons, might have the effect to subrogate the lender to their rights, and entitle him to hold the coupons as part of the debt secured by the mortgage.[24]

§ 588a. The North Carolina statute declaring that incorporated companies shall not have power in mortgages to exempt the property of such corporations from execution for labor performed, nor for material furnished, nor for torts committed, was amended by striking therefrom the words "for material furnished such corporation." Since this amendment the right of priority is confined to "labor performed," and the amendment expressly excludes "materials furnished."[25]

III. *Equities of Claims for Operating Expenses.*

§ 589. A court of equity may make it a condition of its issuing an order for the appointment of a receiver that certain outstanding debts of the company shall be paid from the income that may come into the receiver's hands.[26] Such debts are usually those in-

[24] See § 252.

[25] Cheesborough v. Sanatorium, 134 N. C. 245; 46 S. E. 494. See, also, Dunavant v. Caldwell &c. R. Co. 122 N. C. 999; 29 S. E. 837, and Pocahontas Coal Co. v. Henderson &c. Co. 118 N. Car. 232; 24 S. E. 22.

[26] Fosdick v. Schall, 99 U. S. 235, 252; Miltenberger v. Logansport R. Co. 106 U. S. 286; 1 Sup. Ct. 140; Union Trust Co. v. Souther, 107 U. S. 591; 2 Sup. Ct. 295; Thomas v. Peoria &c. R. Co. 36 Am. & Eng. R. Cas. 381; Burnham v. Bowen, 111 U. S. 776; 4 Sup. Ct. 675; Pickering v. Townsend, 118 Ala. 351; 20 So. 703; Drennen v. Mercantile &c. Co. 115 Ala. 592; 23 So. 164; 39 L. R. A. 623; 67 Am. St. 72; McIlhenny v. Binz, 80 Tex. 1; 13 S. W. 655; 26 Am. St. 705; Litzenberger v. Jarvis-Conklin Trust Co. 8 Utah, 15; 28 Pac. 871. In Fosdick v. Schall, 99 U. S. 235, 252, the leading case on this subject, Chief Justice Waite, delivering the judgment, said: "The business of all railroad companies is done to a greater or less extent on credit. This credit is longer or shorter, as the necessities of the case require; and when companies become pecuniarily embarrassed, it frequently happens that debts for labor, supplies, equipment, and improvements are permitted to accumulate, in order that bonded interest may be paid and a disastrous foreclosure postponed, if not altogether avoided.

curred for labor, supplies, equipment, or permanent improvements, within six months prior to the time of making such appointment. The right to impose such terms does not depend alone upon the fact that current earnings have been used by the company to pay the mortgage debt, principal, or interest, instead of current expenses. Other circumstances may make such an order reasonable. Thus, if the bondholders do not take possession or commence proceedings to foreclose their mortgage upon the happening of a default, but allow the com-

In this way the daily and monthly earnings, which ordinarily should go to pay the daily and monthly expenses, are kept from those to whom in equity they belong, and used to pay the mortgage debt. The income out of which the mortgagee is to be paid is the net income. If for the convenience of the gross earnings what is required for necessary operating and managing expenses, proper equipment, and useful improvements. Every railroad mortgagee, in accepting his security, impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If for the convenience of the moment something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require as a condition of such an order that what is due from the earnings to the current debt shall be paid by the court from the future current receipts before anything derived from that source goes to the mortgagees. . . . The mortgagee has his strict rights, which he may enforce in the ordinary way. If he asks no favors, he need grant none. But if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to submit to the operation of a rule which always applies in such cases, and do equity in order to get equity. The appointment of a receiver is not a matter of strict right. Such an application always calls for the exercise of judicial discretion, and the chancellor should so mould his order that, while favoring one, injustice is not done another. If this cannot be accomplished, the application should ordinarily be denied." See, also, Thomas v. Peoria &c. R. Co. 36 Am. & Eng. R. Cas. 381, per Harlan, J. In Bound v. South Carolina R. Co. 48 Fed. 30, the doctrine of preferential lien seems to be put upon the ground that the creditors applying for a receiver must do equity, and hence first mortgage bondholders intervening in a suit by second mortgage creditors are entitled to stand upon their strict legal rights, and will not be postponed to a preferential lien.

pany to operate the road in the expectation that its condition will improve by delay, it being for the interest of the bondholders that the road should be kept in operation, it is proper for the court, in granting an application for the appointment of a receiver, to provide that the debts incurred by the company in thus protecting the security shall be paid from the income of the receivership.[27]

§ 589a. However, the appointment of a receiver vests in the court no absolute control over the property and no general authority to displace vested contract liens. One holding a mortgage debt upon a railroad has the same right to demand and expect from the court respect for his vested and contracted priority as a holder of a mortgage on a farm or lot. When a court appoints a receiver of railroad property, it has no right to make that receivership conditional on the payment of other than those few secured claims which, by the rulings of the court, have been declared to have an equitable priority. In one case the court said: "It is the exception, and not the rule, that such priority of [mortgage] liens can be displaced. We emphasize this fact of the sacredness of contract liens, for the reason that there seems to be growing an idea that the chancellor, in the exercise of his equitable power, has unlimited discretion in this matter of the displacement of vested liens."[28]

§ 590. This equity for the payment of operating expenses may be enforced, though their payment be not provided for in the order appointing the receiver. The court may at any time during the progress of the cause direct the payment of debts which the insolvent company should have paid in the ordinary course of business, out of the income of the receivership. The court may do this "not because the creditors to whom such debts are due have in law a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders; and if they give to one class of creditors that which properly belongs to

[27] Metropolitan Trust Co. v. Tonawanda &c. R. Co. 40 Hun (N. Y.) 80; Union Trust Co. v. Souther, 107 U. S. 591; 2 Sup. Ct. 295.

[28] Kneeland v. American &c. Co. 136 U. S. 89, 97; 10 Sup. Ct. 950; Thomas v. Western Car Co. 149 U. S. 95, 110; 13 Sup. Ct. 824.

another, the court may, upon an adjustment of accounts, so use the income which comes into its own hands as, if practicable, to restore the parties to their original equitable rights. . . . No fixed and inflexible rule can be laid down for the government of the courts in all cases. Each case will necessarily have its own peculiarities, which must to a greater or less extent influence the chancellor when he comes to act. The power rests upon the fact that in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done, therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained. It follows that if there has been in reality no diversion, there can be no restoration; and that the amount of restoration should be made to depend upon the amount of the diversion. If in the exercise of this power errors are committed, they, like others, are open to correction on appeal. All depends upon a proper application of well-settled rules of equity jurisprudence to the facts of the case, as established by the evidence."[29]

After the appointment of a receiver the court will at its discretion apply the net income to the payment of employes and materialmen, who have, prior to the appointment, furnished labor, materials, or supplies necessary for the operation of the road.[30]

§ 591. Although the mortgagor has been allowed to remain in

[29] Fosdick v. Schall, 99 U. S. 235, 253, 254, per Chief Justice Waite. See, also, Poland v. Lamoille &c. R. Co. 52 Vt. 144, 177, per Powers, J.; Thomas v. Peoria &c. R. Co. 36 Am. & Eng. R. Cas. 381, per Harlan, J.; Farmers' &c. Co. v. Vicksburg &c. R. Co. 33 Fed. 778. In Cleveland &c. R. Co. v. Knickerbocker Trust Co. 86 Fed. 73, it was said: "The right of the court to prefer the claim . . . in this proceeding, so far as the equities are concerned, is not determined by the order of the court at the instance of the mortgagor railroad company, but rests upon the broad ground of superior equity, and such a preference may be given whether a so-called six-months' claim order is made or not. . . . It is a well recognized principle that the court has jurisdiction of a fund as long as it is in the custody of the court." But see Central Trust Co. v. Chattanooga R. Co. 69 Fed. 295, and Farmers' Co. v. Oregon Pac. R. Co. 31 Or. 237; 48 Pac. 706; 38 L. R. A. 424; 65 Am. St. 822, contra.

[30] Taylor v. Philadelphia &c. R. Co. 7 Fed. 377; Williamson v. Washington City &c. R. Co. 33 Gratt. (Va.) 624.

possession and has applied the income to other purposes, when the mortgagees obtain possession through a receiver, debts incurred by the company for expenses in operating the road should be first paid in priority to mortgage debts.[31] Especially if the mortgage itself provides that the mortgagor shall remain in possession and apply the income of the road to the payment of the current expenses of the road, and the mortgagor is suffered, after default, to remain in possession, to incur debts in operating the road and repairing it, to divert the net earnings to building new road, and thus to enhance the value of the mortgage security, it would be highly inequitable to allow the mortgagees to take possession of the property through receivers, and to assert their mortgage in preference to debts for expenses of operating the road.[32] The right of the supply and labor creditors to payment out of the income of the receivership is not limited to a restoration of the amount paid to mortgage creditors in the way of interest, but the court may direct such payment whenever it appears that the company has used the earnings of the road for making permanent improvements or in providing additional equipments for the road, thereby leaving supply and labor debts unpaid.[33]

§ 592. A diversion of the earnings of a railroad from the payment of operating expenses to the payment of interest on bonds is not shown by the fact that through an extended period the gross receipts would have been sufficient to meet all operating expenses if no interest had been paid, when the payments of interest were made in the early part of the period before there had been any default in the payment of operating expenses.[34] If interest is paid or improvements made out of borrowed money, then there is no diversion; or if made out of gross earnings, and the latter is reimbursed by borrowed money, the diversion is made good.[35]

No claim for a diversion of net earnings can be sustained as against

[31] Williamson v. Washington City &c. R. Co. 33 Gratt. (Va.) 624; Lehigh &c. Co. v. Central R. Co. 34 N. J. Eq. 88; Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 315.

[32] Poland v. Lamoille R. Co. 52 Vt. 144.

[33] Williamson v. Washington City &c. R. Co. 33 Gratt. (Va.) 624.

[34] St. Louis &c. R. Co. v. Cleveland &c. R. Co. 125 U. S. 658; 8 Sup. Ct. 1011; 33 Am. & Eng. R. Cas. 16.

[35] Central Trust Co. v. East Tennessee &c. R. Co. 80 Fed. 624.

the holders of second mortgage bonds, when such earnings were misapplied, if misapplied at all, by payment of interest on first mortgage bonds.[36] The fund for distribution, in the sense of the sale sought to be applied, cannot be said to have been benefited by the payment to other bondholders. If any equity exists in such case, it is against the holders of the first mortgage bonds, who actually received the money.

If the receiver has diverted earnings of the road to the payment of interest on receiver's certificates payable out of the *corpus* of the mortgaged property, or to the payment of costs or allowances in the foreclosure suit, or to the payment of any other claims not properly for operating expenses, such earnings must be returned to the current earnings fund, and applied to the payment of claims made payable therefrom.[37]

The creditor can only concern himself about diversions of the current earnings after the creation of his debt. It devolves upon an intervener to show that sums were diverted after the creation of his claim, and he must show by his evidence into what the diverted sums went, so that the court can determine whether it was an improvement or betterment which inured to the benefit of the mortgages.[38]

A diversion of income for the benefit of mortgage bondholders, either in payment of interest or expenditures for permanent improvements, is not necessary to give rise to a preferential lien. The equity of a current supply claimant in subsequent income, arising from the operation of the road under the direction of the court, is not affected by the fact that income is misappropriated and diverted to purposes which do not inure to the benefit of bondholders, and are foreign to the preservation of the property.[39]

§ 593. As regards this doctrine, there is a vital distinction be-

[36] St. Louis &c. R. Co. v. Cleveland &c. R. Co. 125 U. S. 658; 8 Sup. Ct. 1011; 33 Am. & Eng. R. Cas. 16; Central Trust Co. v. East Tennessee &c. R. Co. 80 Fed. 624.

[37] Blair v. St. Louis &c. R. Co. 25 Fed. 232; Calhoun v. St. Louis &c. R. Co. 14 Fed. 9.

[38] Kansas &c. Co. v. Elec. R. &c. Co. 108 Fed. 702.

[39] Miltenberger v. Logansport R. Co. 106 U. S. 286, 311, 312; 1 Sup. Ct. 140; Union Trust Co. v. Illinois &c. R. Co. 117 U. S. 434; 6 Sup. Ct. 809; Virginia &c. Co. v. Central R. &c. Co. 170 U. S. 355; 18 Sup. Ct. 657.

tween a debt for construction and one for operating expenses. Extraordinary expenses, outside of the ordinary course of business, and incurred for purposes not of repair but of construction, are not included.[40] The doctrine applies only to a debt for operating expenses; it does not apply to a debt for original construction;[41] or to any claim of a general creditor other than for operating expenses.[42] "The material for the building or construction of the works, in theory, at least, is supposed to be paid out of the capital stock, or bonds secured by mortgage upon the property. It is from this source that companies raise the money with which to construct their works, and they depend upon the earnings or income after the works are constructed to pay for their operating labor and supplies, and pay interest upon their bonds, and dividends to their shareholders."[43] Accordingly, where a receiver of a corporation engaged in the manufacture of gas was directed by the order appointing him to keep the works in operation, to make necessary repairs, and to pay the debts of employes, and bills for supplies and operating materials contracted within sixty days prior to his appointment, it was held that he was not authorized to pay a claim for meters supplied to the company, because the claim was not for operating or supply

[40] Lackawanna &c. Co. v. Farmers' &c. Co. 176 U. S. 298 316; 20 Sup. Ct. 363.

[41] Cowdrey v. Galveston &c. R. Co. 93 U. S. 352; Wood v. Guarantee &c. Co. 9 Sup. Ct. 131, per Lamar, J.; Porter v. Pittsburgh &c. Co. 120 U. S. 649; 7 Sup. Ct. 741; 30 Am. & Eng. R. Cas. 472; affirmed on rehearing 122 U. S. 267; 7 Sup. Ct. 1206; 30 Am. & Eng. R. Cas. 495; Farmers' &c. Co. v. Pine Bluff &c. R. Co. 57 Ark. 334; 21 S. W. 652; Toledo &c. R. Co. v. Hamilton, 134 U. S. 296; 10 Sup. Ct. 546; McIlhenny v. Binz, 80 Tex. 1; 13 S. W. 655; 26 Am. St. 705; Farmers' &c. Co. v. Stuttgart &c. R. Co. 92 Fed. 246; Niles Tool Works Co. v. Louisville &c. R. Co. 112 Fed. 561; Farmers' &c. Co. v. Cape Fear &c. R. Co. 73 Fed. 712; American &c. Co. v. East &c. R. Co. 46 Fed. 101.

[42] Kelly, In re, 5 Fed. Rep. 846; Hervey v. Illinois M. R. Co. 28 Fed. 169; Hiles v. Case, 14 Fed. 141; Dexterville Mfg. Co. v. Receiver, 4 Fed. 873; Davenport v. Receivers, 2 Woods (U. S.), 519; Olyphant v. St. Louis &c. Co. 28 Fed. 729; Central Trust Co. v. Wabash &c. R. Co. 28 Fed. 871; Central Trust Co. v. East Tenn. &c. R. Co. 30 Fed. 895.

[43] Reyburn v. Consumers' &c. Co. 29 Fed. 561, 564, per Blodgett, J.

materials, but of the nature of materials used in the construction of the works.[44]

§ 593a. **The term "original construction"** has been declared to have a technical meaning in this connection. It is that construction that is necessary to be done before the road can be opened or before it can be occupied or used, but not such structures as are intended to replace old or worn-out counter-parts. It is the history of all first-class railroads that year after year the cheaper structures are replaced by better and more expensive ones.[45]

A claim for the price of machinery sold to a mortgagor railway, and used in the construction of shops not included in the mortgage, is not entitled to priority of payment over the mortgage debt in a foreclosure suit as a preferential lien, there being no surplus of income from the receivership and no diversion of current income.[46] A claim made by a lessor of terminal property to a railway company for the construction of new terminal tracks is not one for current repairs or for ordinary operating expenses, which entitles it to preferential payment from current income. Manifestly such a debt is no part of the current expenses of operating or maintaining the railroad as a going concern. It is a debt incurred in a scheme of extending the road. The construction of such new tracks is original construction, and neither current repairs nor ordinary operating expenses.[47]

§ 594. **The class of preferred debts to be so paid** includes taxes on the property; the wages of officers and employes of every grade employed in operating the road; the cost of materials and supplies furnished which are necessary to put the road and its rolling stock in a safe condition for the transportation of persons and property, and to keep them so; and the balances due to other railroads and lines of transportation on account of passenger tickets and freight charges.[48]

[44] Reyburn v. Consumers' &c. Co. 29 Fed. 561, 564, per Blodgett, J.

[45] Cleveland &c. R. Co. v. Knickerbocker Trust Co. 86 Fed. 73.

[46] Niles Tool Works Co. v. Louisville &c. R. Co. 112 Fed. 561.

[47] St. Louis &c. Co. v. Continental Trust Co. 111 Fed. 669.

[48] Farmers' &c. Co. v. Vicksburg &c. R. Co. 33 Fed. 778, per Hill, J.

In **Mississippi** it is provided that

But it has been declared that there is no case wherein this extraordinary preference has been allowed to a judgment on a tort of the corporation committed before the receivership.[49]

A claim against a railway for rental of terminal property accruing under a lease within the six months prior to a receivership is entitled to priority of payment out of a fund in court produced by the operation of the road by the receivers.[50]

One who, as agent for a railroad company, pays taxes due on its property, is entitled to a lien thereon for the amount advanced, superior to that of a mortgage.[51]

It is not within the scope of this work to give a list of all articles which have been held essential to the operation of a railway, but some examples may serve to show the method used to determine such questions. Motive power is a prime requisite for every railroad, and on this ground a cable furnished a cable road was held an article necessary for the operation of the road.[52] Waiting rooms and ticket offices are essential requirements for passenger service, and so the supply bills for materials used in such buildings have been given a preferential lien.[53] Claims for heating and lighting waiting rooms come within the same principle and are entitled to the same priority.[54]

§ 595. On this ground the attorney of a railroad company is entitled to the payment of his annual salary, which has fallen due

no mortgage of the income, future earnings, or rolling stock of a railroad corporation shall be valid against debts contracted in carrying on the business of the corporation. R. Code 1880, § 1033. This statute does not give a prior lien to the holders of such claims, but merely prevents those claiming a prior lien under such mortgage from setting it up to defeat such claims. Farmers' &c. Co. v. Vicksburg &c. R. Co. 33 Fed. 778. By statute in Arkansas Sand. & H. Dig. §§ 1425, 1426, a railroad attorney receiving a monthly salary is not entitled to a preference. Latta v. Lonsdale, 107 Fed. 585. A claim for the value of coupling links and pins is entitled to a preferential lien. Wood v. New York &c. R. Co. 70 Fed. 741.

[49] Hampton v. Norfolk &c. R. Co. 127 Fed. 662.

[50] Manhattan Trust Co. v. Sioux City &c. R. Co. 102 Fed. 710.

[51] Farmers' &c. Co. v. Stuttgart &c. R. Co. 92 Fed. 246.

[52] New York &c. Co. v. Tacoma R. &c. Co. 83 Fed. 365; Central Trust Co. v. Clark, 81 Fed. 269.

[53] Railroad Co. v. Lamont, 69 Fed. 23; 16 C. C. A. 364.

[54] Northern Pac. R. Co. v. Lamont, 69 Fed. 23; 16 C. C. A. 364.

only a short time before the appointment of a receiver of the railroad, in priority to the mortgage bondholders. The services of an attorney are considered necessary to the ordinary administration of the affairs of a railroad corporation.[55] But such attorney is not entitled to any preference as regards fees earned a year and a half before the appointment of a receiver. Neither is he entitled to such preference as regards money paid by him upon judgments against the railroad company, and upon claims for wages and for stock killed, under an agreement that the amount so advanced should be repaid by the company, though the payments were so made by him within six months before the appointment of a receiver. He simply loaned the money to the railroad company without security. If he had taken a mortgage at the time of making the loan, he would not have claimed priority of payment over an existing mortgage.[56]

A statute which provided that in a foreclosure sale of a railroad the court should provide in the decree or otherwise that the purchaser should pay all sums due to any servant or employe of the company, was held not to include a secretary of such railroad company.[57]

§ 595a. It has been declared that three things are necessary to give a claim against a railroad company, in the hands of a receiver, a preference over a mortgage lien: 1. The supplies furnished must be of the ordinary and necessary character for operating a railroad and keeping the mortgaged property a going concern; 2. That the person furnishing them relied upon the interposition and protection of his equity by the court, and did not contract upon the personal responsibility of the railroad company; 3. That the debt was contracted but a short time before the appointment of the receiver, and was left unpaid because of the sudden action of the court in making such appointment.[58]

A general unsecured creditor of an insolvent railway company in the hands of a receiver is not entitled to priority over mortgage

[55] Blair v. St. Louis &c. R. Co. 23 Fed. 521; 23 Fed. 523; Bayliss v. Lafayette &c. R. Co. 9 Biss. (U. S.) 90.

[56] Blair v. St. Louis &c. R. Co. 23 Fed. 521.

[57] Wells v. Southern Minnesota R. Co. 1 McCrary (U. S.), 18; 1 Fed. 270.

[58] Southern R. Co. v. Ensign Mfg. Co. 117 Fed. 417.

creditors in the distribution of net earnings simply because he furnished materials for the preservation of the property prior to the appointment of the receiver. Before such a creditor is accorded a preference, it should reasonably appear from all the circumstances, including the amount involved and the terms of payment, that the debt is one fairly to be regarded as part of the operating expenses of the railroad incurred in the ordinary course of business, and to be met out of current receipts.[59] Demanding and receiving collateral security is a circumstance tending to show that the creditor does not regard itself as entitled to an equitable claim to net earnings in preference to mortgage creditors, but relied upon the general credit of the railroad company.[60] Likewise, extending a note given in payment for iron rails was sufficient to show the seller did not rely on the earnings of the road for payment, and he could not claim a preferential lien by showing a diversion of current earnings to the payment of mortgage interest.[61]

In a case carried to the Supreme Court on appeal a purchasing agent of the Richmond and Danville Railroad Company, while that company was operating the Central Railroad of Georgia, contracted with a coal company to furnish coal to the Central road. The coal not having been paid for, the coal company intervened in a suit in which the receiver of the Central road and the Richmond and Danville Railroad Company were parties. The claim against the Richmond and Danville was under the contract; that against the Central was through the equity, in that the coal was purchased for the use of and was used by the Central road. The Supreme Court held that the equity existed against the Central Railroad, because the supplies were used in its operation, notwithstanding the contract of purchase was that of its lessee. The legal contract was with the Richmond and Danville, but when it was sought to enforce the equity, the earnings of the Central were liable for it.[62] This case of the Richmond and Danville Company has since been said to rest on the

[59] Southern R. Co. v. Carnegie Steel Co. 176 U. S. 257; 20 Sup. Ct. 347.

[60] Lackawanna &c. Co. v. Farmers' &c. Co. 176 U. S. 298; 20 Sup. Ct. 363.

[61] Bound v. South Carolina R. Co. 58 Fed. 473.

[62] Virginia &c. Co. v. Central R. &c. Co. 170 U. S. 355; 18 Sup. Ct. 657; 42 L. Ed. 1068.

ground that the bills were originally made out against the owning company, and the offer and acceptance were expressly on behalf of the owning company. So, where the lessee of a railroad made a contract in its own name for steel rails, and gave its own notes for the purchase price, the use of such rails upon the property of the lessor road did not give rise to a preferential lien. The proposition that the rails were sold to the lessee company while in possession and operating the railroad, and not to the lessor company, completely removes every ground on which this debt should be treated as entitled to a preference.[63]

Taxes paid by a lessor railroad have been held to be a preferred claim against the lessee road, having priority over a mortgage indebtedness. By the terms of the lease the lessee was to pay all taxes, and in the order appointing a receiver for the lessee road, the receiver was directed to pay all amounts due as taxes for any part of the property. Furthermore, counsel fees and expenses incurred by the lessor in resisting an increased assessment could properly be charged to the receiver of the lessee, and would be a part of the preferred claim.[64]

Since, as has already appeared, the preferential lien applies only to income and not to the *corpus* of the property, it is also necessary for the supply creditor to show either that there are net or current earnings in the hands of the receiver applicable to the payment of such debts, or that there has been a diversion of current earnings which the mortgagee should equitably restore.[65]

§ 596. **Under this principle are also included the payment of limited amounts due to connecting roads** for materials and repairs, and for unpaid ticket and freight balances, the outcome of indispensable business relations, where an interruption of such relations would be a probable result in case of non-payment. In view of the consequences both to the company and the public involved in the breaking off of such traffic relations, the payment of such claims

[63] Ruhlender v. Chesapeake &c. R. Co. 91 Fed. 5.

[64] United States Trust Co. v. Mercantile Trust Co. 88 Fed. 140, affirming 80 Fed. 18.

[65] Rhode Island &c. Works v. Continental Trust Co. 108 Fed. 5.

"may well be placed in the category of payments made to preserve the mortgaged property."[66]

But when one railroad company assumes the management of another, all the earnings of both being deposited in a common fund from which the expenses of both are paid, the former is not a supplier of materials to the latter, so as to be entitled to a preferential lien for the amount expended over and above the amount received, but any such excess is only a loan of money.[67]

§ 597. This principle has been extended to the protection of one who has rescued the mortgaged property by becoming a surety on a bond given by a railroad company on obtaining an injunction against a threatened levy of execution upon the rolling stock of that road, which, with the road, was subject to a mortgage. The injunction having been dissolved, and a judgment recovered against the surety, it was held that he had an equity to be paid out of the pro-

[66] Miltenberger v. Logansport R. Co. 106 U. S. 286; 1 Sup. Ct. 140; Easton v. Houston &c. R. Co. 38 Fed. 12; Farmers' &c. Co. v. Vicksburg &c. R. Co. 33 Fed. 778; Ames v. Union Pac. R. Co. 73 Fed. 49; Finance Co. v. Charleston &c. R. Co. 62 Fed. 205.

Mr. Justice Blatchford, delivering a judgment of the Supreme Court of the United States in the case first cited, said: "It is easy to see that the payment of unpaid debts for operating expenses, accrued within ninety days, due by a railroad company suddenly deprived of the control of its property, due to operatives in its employ, whose cessation from work simultaneously is to be deprecated, in the interest both of the property and of the public, and the payment of limited amounts due to other connecting lines of road for materials and repairs and for unpaid ticket and freight balances, the outcome of indispensable business relations, where a stoppage of the continuance of such business relations would be a probable result, in case of non-payment, the general consequences involving largely also the interests and accommodations of travel and traffic, may well place such payments in the category of payments to preserve the mortgaged property in a large sense, by maintaining the good will and integrity of the enterprise, and entitle them to be made a first lien."

See, also, Metropolitan Trust Co. v. Tonawanda R. Co. 40 Hun (N. Y.), 80; Douglass v. Cline, 12 Bush (Ky.), 608.

The principle was not recognized in the earlier cases of Ketchum v. Pacific R. Co. 3 Cent. L. J. 637, and Jessup v. Atlantic &c. R. Co. 3 Woods (U. S.), 441.

[67] United States Trust Co. v. Western Contract Co. 81 Fed. 454.

ceeds of a foreclosure sale of the property, it appearing that the receiver appointed in the foreclosure proceedings has used earnings to increase the *corpus* of the estate; especially where the bondholders became the purchasers at the foreclosure sale, and the sale was expressly made subject to such intervening claims as might be declared paramount.[68]

The claim of the surety was based upon a *bona fide* effort to preserve the mortgage fund from waste and spoliation after the mortgage debt was in arrears and the mortgagee was entitled to take possession. The mortgaged rolling stock was in danger of being seized and removed. The surety, at the instance of the company, put his hands into the fire to rescue it. The mortgagee received the benefit of his act,—both directly, by having the property preserved without being obliged to take any proceedings to rescue it, and indirectly, by having the railroad kept up as a going concern. The surety's money went to the benefit of the mortgagee. The surety's claim was not a claim to be subrogated to the lien of the judgment creditor, but a claim founded on the equities arising in his favor for taking the action he did, resulting to the benefit of the mortgagees.

In Whiteley v. Central Trust Co.[69] a surety on a supersedeas bond was not allowed a preferential lien over existing mortgages. The railway company was solvent at the time the bond was signed and interest on mortgage indebtedness was paid to date, so that the surety was presumed to have trusted the principal and not the property. This case arose in the Circuit Court for the District of Kentucky, and the Circuit Court of Appeals distinguished two Kentucky cases which reached the opposite result. The first case[70] was distinguished upon the ground that in it the surety took a chattel mortgage on four engines, and the second[71] was distinguished on the ground that the mortgagee had allowed the railroad company to continue in possession and manage the property after a long default in payment of interest.

[68] Union Trust Co. v. Morrison, 125 U. S. 591; 8 Sup. Ct. 1004; 33 Am. & Eng. R. Cas. 33; Jones v. Central Trust Co. 73 Fed. 569; Farmers' &c. Co. v. Northern Pac. R. Co. 71 Fed. 245.

[69] 76 Fed. 74.

[70] Johnson v. Morrison, 5 B. Mon. (Ky.) 107.

[71] Bank v. Ruddy, 2 Bush. (Ky.), 329.

In a case[72] arising in the Circuit Court for the Eastern District of Wisconsin a surety on a supersedeas bond was not allowed a preferential lien for the amount he had been forced to pay by reason of his contract of suretyship. The court point out that the case of Union Trust Co. v. Morrison[73] was decided on special facts, and is not to be considered as overruling an earlier decision[74] by Justice Brewer sitting as a circuit judge. "The [Morrison] case," said Jenkins, J., "is peculiar in its facts, and is plainly distinguishable from the case here presented."

§ 598. On this principle, bondholders who have advanced money necessary for the payment of wages due employes, in order to prevent a threatened strike, on a direct understanding that they should be reimbursed out of the first net earnings of the company, should be repaid out of the income in the hands of a receiver appointed before the railroad company could reimburse them. The bondholders are entitled to be paid such advances in preference to the claims of the mortgagees.[75]

§ 599. But a general loan is not entitled to such preference. A bank which has loaned money to a railroad company shortly before the commencement of the foreclosure suit, the money going into the general funds of the company, and not especially to the payment of mortgage interest, has only the rights of a general creditor in the distribution of the proceeds of a sale of the mortgaged property, provided there was no fraud or deception on the part of the trustees, and no misuse of current income by the receiver to the injury of the bank.[76] On the same principle a general loan to a construction company to enable it to operate a railway is not entitled to repayment out of the assets of the road in preference to bondholders.[77]

In like manner a claim for advances made to a railroad company

[72] Farmers' &c. Co. v. Northern Pac. R. Co. 68 Fed. 36.

[73] 125 U. S. 591; 8 Sup. Ct. 1004.

[74] Blair v. Railroad Co. 23 Fed. 523.

[75] Atkins v. Petersburg R. Co. 3 Hughes (U. S.), 307.

[76] Penn v. Calhoun, 121 U. S. 251; 7 Sup. Ct. 906; Morgan's &c. Co. v. Texas Cent. R. Co. 137 U. S. 171; 11 Sup. Ct. 61; Southern Devel. Co. v. Farmers' &c. Co. 79 Fed. 212; Farmers' &c. Co. v. Stuttgart &c. R. Co. 92 Fed. 246.

[77] Exchange Bank v. Macon Const. Co. 97 Ga. 1; 25 S. E. 326.

to complete its construction will be postponed in equity to the lien of the mortgage bondholders, unless the advances were made in consequence of the requests, promises, or acts of all the bondholders.[78]

But where an advance was made to an electric railway company to enable it to build an additional power house and thus retain its franchise, on the express terms that the loan should be repaid out of current earnings, the amount advanced constituted a preferential lien as against mortgagees.[79]

A party lending money to an embarrassed corporation and taking security therefor is not in a position which entitles him in equity to be adjudged to have a lien on mortgaged property of the corporation or its proceeds in preference to bondholders under an existing mortgage, and it is immaterial for what purpose the loan was made or how the money received thereon was applied, provided the bondholders were not parties.[80]

§ 600. A claim for rent of cars during a receivership may be charged upon the income, and, if that is insufficient, upon the proceeds of the property; yet, in the absence of special circumstances, a claim for such rent which accrued prior to the appointment of the receiver will not be allowed.[81]

A receiver is not bound to adopt car-trust contracts, and does not assume liability simply by taking possession of the cars and using them temporarily. He is entitled to a reasonable time to ascertain whether it is profitable to assume the obligations and to elect whether he will adopt them.[82]

A claim by a lessor for repairs of cars first made in an amended petition filed three years after the surrender of the cars to the les-

[78] Kelly, In re, 5 Fed. 846.

[79] Illinois &c. Bank v. Ottumwa Elec. R. 89 Fed. 235.

[80] Farmers' &c. Co. v. Bankers &c. Co. 148 N. Y. 315; 42 N. E. 707; 31 L. R. A. 403; 51 Am. St. 690.

[81] Thomas v. Western Car Co. 149 U. S. 95, reversing Mather &c. Co. v. Anderson, 76 Fed. 164; 36 Am. & Eng. R. Cas. 381; Grand Trunk R. Co. v. Central Vermont R. Co. 90 Fed. 163; Pullman's &c. Car Co. v. American &c. Co. 84 Fed. 18; 28 C. C. A. 263. But see Lane v. Macon &c. R. Co. 96 Ga. 630; 24 S. E. 157, where the conduct of the trustee was such that he was charged with assenting to priority for rental of leased cars.

[82] Platt v. Philadelphia &c. R. Co. 84 Fed. 535; U. S. Trust Co. v. Wabash R. Co. 150 U. S. 287; 14 Sup. Ct. 86.

sor, when no claim had been made upon the receiver pending foreclosure, will be rejected.[83]

Where, however, the vendor of rolling stock, who has retained the title thereto under a conditional sale, or has retained a lien thereon, has exhausted his own security, he occupies the position of a general creditor only for any balance that may be due him from the company.[84]

A lease of rolling stock will be disregarded as a basis of claims for rental upon the proceeds of a foreclosure sale, when it appears that the lessor company and the railroad company were both dominated and controlled by substantially the same persons. The car company is in such case entitled only to such reasonable rent as it could obtain in the open market for similar cars to be used in the same manner.[85]

A claim by locomotive works for locomotives furnished a railroad as part of necessary equipment has been allowed as a preferential lien. This equipment was furnished at a time when it was needed to keep the road up as a going concern, and seems on this ground to be considered as part of the operating expenses.[86]

[83] Thomas v. Peoria &c. R. Co. 36 Am. & Eng. R. Cas. 381.

[84] Fosdick v. Schall, 99 U. S. 235; Huidekoper v. Locomotive Works, 99 U. S. 258; Fidelity &c. Co. v. Shenandoah &c. R. Co. 86 Va. 1; 9 S. E. 759; 19 Am. St. 858.

[85] Thomas v. Peoria &c. R. Co. 36 Am. & Eng. R. Cas. 381; Thomas v. Brownville &c. R. Co. 109 U. S. 522; 3 Sup. Ct. 315; 16 Am. & Eng. R. Cas. 557; Wright v. Kentucky &c. R. Co. 117 U. S. 72, 94; 6 Sup. Ct. 697; 24 Am. & Eng. R. Cas. 312; Wardwell v. Railroad Co. 103 U. S. 651, 658; 1 Am. & Eng. R. Cas. 427. In the latter case the court said: "The directors of corporations cannot enter into or authorize contracts in behalf of those for whom they are appointed to act, and then personally participate in its benefits. Hence all arrangements by directors of a railroad company to secure an undue advantage to themselves at its expense, by the formation of a new company as auxiliary to the original one, with an understanding that they, or some of them, shall take stock in it, and then that valuable contracts shall be given to it, in the profits of which they, as stockholders in the new company, are to share, are so many unlawful devices to enrich themselves to the detriment of the stockholders and creditors of the original company, and will be condemned, whenever properly brought before the courts for consideration."

[86] Continental Trust Co. v. Toledo &c. R. Co. 93 Fed. 532.

Cars furnished to a railroad by other roads in the course of business are materials furnished for the operation of the road, and claims for their loss when destroyed and not returned are properly payable by receivers under an order for the payment of claims for the expenses of operation.[87]

§ 600a. **Rental for track privilege accruing prior to the appointment of a receiver** is not entitled to a preferential lien. The nature of such a claim is of a kind which, upon the general current of authority, disentitles it to a position of priority over the mortgage debt. It stands upon no higher or better grounds than claims for rental of rolling stock, which are quite as indispensable to the daily operation of a railroad as are its tracks; and, with respect to track rentals for the period prior to the accession of the receiver, they are not, as a general rule, recognized as entitled to priority.[88] This general rule applies where the receiver is asked for by the company itself, and continues to operate leased lines.[89] This doctrine must not, however, be confused with cases where the receivership proceedings terminate the lease, and a separate receiver is appointed to administer the lessor road. In that case materials supplied to the lessor and used upon it constitute a preferential lien upon income to the extent of their contract price.[90]

Rental due a lessor railroad is not subject to any deduction on account of expenses incurred by a receiver of the lessee road, whether in the way of necessary repairs or reconstruction and substitution. The only relation which exists between the lessor and the receiver results from the fact that the court ordered the receiver to take possession of the leasehold property and pay rent, the lessor not being a party to the litigation at any stage of the case. The public duty of maintaining the railway rests on the lessee alone; all creditors are creditors of the lessee, and at no time had the right to look to the property of the lessor for the satisfaction of the debt. At common

[87] Grand Trunk R. Co. v. Central Vermont R. Co. 88 Fed. 636.

[88] Louisville &c. R. Co. v. Central Trust Co. 87 Fed. 500; Central Trust Co. v. Charlotte &c. R. Co. 65 Fed. 264.

[89] Central Trust Co. v. Wabash &c. R. Co. 46 Fed. 26.

[90] Stewart v. Wisconsin Cent. R. Co. 95 Fed. 577.

law the duty to repair was placed upon the tenant, and the common law doctrine is applicable to railroad leases.[91]

Rent properly due for a railroad used by a receiver under an order of court is a receivership expense, and entitled to preferential payment.[92]

§ 601. In exceptional cases claims not for operating expenses may have an equity as against the mortgage lien. Such an equity was established in a case where the bondholders, having obtained a decree of foreclosure, instead of making a sale with the concurrence of the company, transferred the entire property by a perpetual lease to another corporation under an arrangement whereby the rental was to go to the bondholders and the surplus to the lessor company, without making any provision for the payment of the floating debts of the company. The holders of unsecured notes given for the construction of the company's road intervened after the foreclosure decree, and prayed that these debts be established as equitable liens upon the property paramount to the lien of the mortgage; and under the circumstances the court granted the relief. It did this upon the ground that, by the arrangement by which the sale was arrested, the unsecured creditors were deprived of their right of satisfaction out of any surplus there might result from the sale; and that the entire property was transferred to another corporation, and the bondholders secured, without leaving the debtor corporation any means whatever to pay its debts.[93]

§ 602. No equitable lien arises in behalf of a general creditor in consequence of the receiver's applying net income to permanent improvements. Though the income is primarily pledged to the mortgage bondholders, they may, for reasons of their own, assent to the application of it to the permanent improvement of the property. If the court, or the receiver under the direction of the court, invests the earnings in this way, no one but the secured creditors who have a lien upon the earnings can complain. A general creditor whose

[91] Felton v. City of Cincinnati, 95 Fed. 336.

[92] Mercantile Trust Co. v. Farmers' &c. Co. 81 Fed. 254; 26 C. C. A. 383.

[93] Farmers' &c. Co. v. Missouri &c. R. Co. 21 Fed. 264.

claim is not for operating material or labor has no equitable lien upon the income; and the fact that the income is invested to the permanent improvement of the property creates no equitable lien in his favor, to be paid out of the proceeds of a foreclosure sale of the improved property, in preference to mortgage bondholders who have a vested lien upon the income and the property itself.[94]

The same principle applies to a case where accrued income is turned over to the receiver. On such ground alone a judgment creditor for personal injuries cannot claim payment in preference to the bondholders, the fund passing into the receiver's hands free from any lien or charge.[95]

In Virginia, however, it is held that where there are judgments and executions against a railroad company outstanding at the time a receiver is appointed in a foreclosure suit, and there are funds derived from income in the hands of the company, or due to it at that time, the judgment and execution creditors are entitled to have such funds applied to the satisfaction of their judgment liens in preference to the mortgage creditors. If such funds have been applied by the receiver under the order of the court to other debts, they will be replaced out of the revenues received by the receiver after his appointment.[96]

§ 603. Claims against a railroad company as a common carrier for damages to passengers or property are not operating expenses, entitled to payment in priority to the claims of mortgage creditors. Such claims are not "expenses" in the proper sense of the word. They are only liabilities resulting secondarily from operating the road.[97]

[94] Reyburn v. Consumers' &c. Co. 29 Fed. 561; Dexterville Manufacturing Co. In re, 4 Fed. 873; Hiles v. Case, 14 Fed. 141; Hervey v. Illinois &c. R. Co. 28 Fed. 169; Olyphant v. St. Louis &c. Co. 28 Fed. 729; Central Trust Co. v. Wabash &c. R. Co. 28 Fed. 871; Central Trust Co. v. East Tennessee &c. R. Co. 30 Fed. 895; Davenport v. Receivers, 2 Woods (U. S.), 519.

[95] Farmers' &c. Co. v. Detroit &c. R. Co. 71 Fed. 29.

[96] Gibert v. Washington City &c. R. 33 Gratt. (Va.) 645.

[97] Farmers' &c. Co. v. Vicksburg &c. R. Co. 33 Fed. 778; Easton v. Houston &c. R. Co. 38 Fed. 12; Davenport v. Receivers, 2 Woods (U. S.), 519; Central Trust Co. v. Wabash &c. R. Co. 28 Fed. 871; 32 Fed. 566; Hiles v. Case, 9 Biss.

The underlying principle for determining when a debt of a railroad company is entitled to priority of payment is, that it operated in a direct way when it was incurred to the advantage of the mortgage bondholders.[98]

A judgment against the corporation for personal injuries is not a claim for operating expenses, and is not entitled to priority of satisfaction out of the earnings of the receivership; and, *a fortiori,* not out of the expenses of the estate.[99] This principle has been applied to a case where the injury occurred while a temporary receiver was operating the road pending *quo warranto* proceedings. Such a claim was not entitled to a preferential lien against a subsequent receiver.[100]

A claim against a receiver for losses occasioned by a fire set by sparks from defective engines has no superior equity by reason that the fire occurred after a default of the railroad company, and that the company was operating the road at the time. The company was not operating the road as the agent or trustee in equity of the bondholders. The latter could have taken possession had they chosen. The negligence was the negligence of the company, not of the bondholders.[101]

By statute in Ohio[102] mortgage bonds issued by reorganized railway companies are postponed to the lien of judgments recovered against the reorganized companies for labor and materials or for torts. A federal court gave effect to this act in respect to such part of the road of a reorganized company extending beyond the state

(U. S.) 549; 14 Fed. 141; Central Trust Co. v. East Tenn. &c. R. Co. 30 Fed. 895; 30 Am. & Eng. R. Cas. 450; Hervey v. Illinois &c. R. Cas. 28 Fed. 169; Olyphant v. St. Louis &c. Co. 28 Fed. 729. See § 514.

[98] Easton v. Houston &c. R. Co. 38 Fed. 12, per Pardee, J.; Central Trust Co. v. East Tenn. &c. R. Co. 30 Fed. 895.

[99] Central Trust Co. v. East Tenn. &c. R. Co. 28 Fed. 871; Fidelity &c. Co. v. Norfolk &c. R. Co. 114 Fed. 389. In the latter case it is held that a state statute giving a judgment in tort priority over a mortgage has no effect in other jurisdictions.

[100] Foreman v. Central Trust Co. 71 Fed. 776.

[101] Hiles v. Case, 9 Biss. (U. S.) 549; Trust Co. v. Riley, 70 Fed. 32; 16 C. C. A. 610; New York &c. Co. v. Louisville &c. R. Co. 79 Fed. 386; Farmers' &c. Co. v. Nestelle, 79 Fed. 748; Farmers' &c. Co. v. Northern Pac. R. Co. 79 Fed. 227; Farmers' &c. Co. v. Northern Pac. R. Co. 74 Fed. 431.

[102] Rev. St. Ohio 1880, §§ 3393–3400.

as lay within the State of Ohio. Unusual privileges were conferred upon reorganization by this law, and it was proper to grant such privileges upon any terms the legislature saw fit.[103]

A similar statute in South Carolina,[104] giving preference to claims for personal injuries, has been held to give a prior lien upon a consolidated road extending through three states, but such decision did not affect property beyond the limits of the state.[105] The preference is enforced, though the accident occurred outside the confines of the state.[106]

Under the Tennessee act,[107] to bring a judgment within the preferred class it must be,—First, for damages done to the person or property; and, second, "in the operation of its railroad in this state." By the terms of this act a judgment for loss of goods destroyed by fire after negligent failure to make prompt delivery was entitled to priority over an existing mortgage.[108] But this statute is limited to judgments on causes of action arising within the state.[109]

The North Carolina Code contains two sections relative to the protection of creditors upon conveyance by a corporation, one of which requires that action shall be commenced within sixty days. A judgment for a tort claim was held to come under the other section, which set no limit as to when action should be begun, because that section in effect recognized and codified the general doctrine of preferential liens.[110]

The Tennessee statute relative to liens against railways for construction expenses applies in favor of sub-contractors only when they give due notice, and then only to the extent of the balance due the original contractor.[111]

§ 604. **Preferred debts for work done and materials furnished are a lien upon all the divisions of the system** in the hands of re-

[103] King v. Thompson, 110 Fed. 319.

[104] Gen. St. 1882, § 1528.

[105] Southern R. Co. v. Bonknight, 70 Fed. 442. See, also, Phinizy v. Augusta &c. R. Co. 63 Fed. 922.

[106] Central Trust Co. v. Charlotte &c. R. Co. 65 Fed. 257.

[107] Law 1877, ch. 12.

[108] Central Trust Co. v. East Tennessee &c. R. Co. 70 Fed. 764.

[109] Central Trust Co. v. East Tennessee &c. R. Co. 69 Fed. 658.

[110] Finance Co. v. Charleston &c. R. Co. 61 Fed. 369.

[111] Central Trust Co. v. Bridges, 57 Fed. 753.

ceivers, though such debts were incurred in the operation of one division of the system. Such debts are a lien upon the entire system prior in right to both local and general mortgages. The mere fact that some of the divisions of the system have been paying operating expenses and others have not, does not justify the casting of the entire burden of the preferred debt upon the non-paying divisions.[112]

Thus necessary supplies furnished a consolidated road would give rise to a preferential lien which would have priority over mortgages on separate divisions of the road.[113]

After a decree foreclosing the general mortgages and directing a sale of the entire system has been entered without objection, and a sale has been made in pursuance of it, it is too late for holders of underlying mortgages to object to the manner in which the earnings of the system have been applied prior to the decree.[114]

§ 605. The purchasers of privileged claims have the same right to payment that the original holders had. Creditors having such claims are not paid because they have in law a lien on the property or income, but because in equity the earnings of the company constitute a fund for the payment of the expenses which their claims represent, before any income arises which ought to be applied to the discharge of the mortgage debt. The equity attaches to the debt, and not to the person of the original creditor. Consequently, the right passes with an assignment of the debt.[115] This doctrine has been applied where receivers operating a trunk line paid current supply bills for a branch road under lease to the main system. The receivers were appointed on the application of stockholders, and for ten months operated the leased property at a loss. At the end of that time the branch road was put into the hands of a receiver, and the indebtedness for operating expenses in excess of income during

[112] Central Trust Co. v. Wabash &c. R. Co. 30 Fed. 332; Calhoun v. St. Louis &c. R. Co. 14 Fed. 9.

[113] Cleveland &c. R. Co. v. Knickerbocker Trust Co. 86 Fed. 73.

[114] Central Trust Co. v. Wabash &c. R. Co. 30 Fed. 332.

[115] Union Trust Co. v. Walker, 107 U. S. 596; 2 Sup. Ct. 299; Burnham v. Bowen, 111 U. S. 776; 4 Sup. Ct. 675; Northern Pac. R. Co. v. Lamont, 69 Fed. 23; Drennen v. Mercantile &c. Co. 115 Ala. 592; 23 So. 164; 39 L. R. A. 623; 67 Am. St. 72.

such period was entitled to a preferential lien, having priority over a mortgage on the branch line.[116]

Rent due for a leased line, as a part of the operating expenses, is not entitled to be paid out of the proceeds of a foreclosure sale in preference to the claims of the mortgage bondholders, in the absence of a showing that the bondholders have been benefited by the payment of the rent.[117]

§ 606. The doctrine of Fosdick v. Schall has rarely been applied to any case other than that of a railroad. The case itself laid great stress on the consideration that a railroad is a peculiar property, of a public nature, and discharging a great public work;[118] and it has been repeatedly declared that this equitable doctrine is not applicable to other corporations.[119]

The exceptional case referred to is one decided in 1895 by the federal Circuit Court for Nebraska, where the doctrine of Fosdick v. Schall was applied in the case of a water-works corporation. The decision is rendered in a well-reasoned opinion, and the limitation of this doctrine to railroad mortgages was evidently not pressed by counsel, as the opinion assumes the same rule applies to all *quasi* public corporations.[120]

In the case of an ordinary private corporation, the general rule is that a court cannot authorize the issue of receivers' certificates without first having the consent of the creditors whose liens would be affected thereby.[121] Furthermore, when a railroad company

[116] Ames v. Union Pac. R. Co. 74 Fed. 335. See post, § 611a.

[117] St. Louis &c. R. Co. v. Cleveland &c. R. Co. 125 U. S. 658; 8 Sup. Ct. 1011; 33 Am. & Eng. R. Cas. 16; Carswell v. Farmers' &c. Co. 74 Fed. 88.

[118] Wood v. Guarantee &c. Co. 129 U. S. 416; 9 Sup. Ct. 131, per Lamar, J.; Burnham v. Bowen, 111 U. S. 776, 781; 4 Sup. Ct. 675; Atkins v. Petersburg Co. 3 Hughes (U. S.), 307, 317.

[119] Seventh Nat. Bank v. Shenandoah Iron Co. 35 Fed. 436; Bound v. South Carolina Ry. Co. 50 Fed. 312; Raht v. Attrill, 106 N. Y. 423; 13 N. E. 282; 60 Am. R. 456; an important case stated in § 555.

[120] Farmers' &c. Co. v. American Waterworks Co. 107 Fed. 23.

[121] Baltimore &c. Ass'n v. Alderson, 90 Fed. 142; Farmers' &c. Co. v. Grape Creek Coal Co. 50 Fed. 481; Hanna v. Trust Co. 70 Fed. 2; 16 C. C. A. 586; Fidelity &c. Co. v. Roanoke Iron Co. 68 Fed. 623; Laughlin v. United States &c. Co. 64 Fed. 25.

branches out from its public functions and conducts a strictly private business, such as a logging camp, the doctrine of Fosdick v. Schall cannot be invoked in favor of the laborers employed in such private business. To hold otherwise would be to put laborers in logging camps upon a like footing with railway employes, and this the law will not warrant or permit.[122] But the doctrine of Fosdick v. Schall has been applied to an electric railway engaged in the business of supplying electricity for lighting purposes. In this case the retention of a contract to supply light to a municipality was declared to be a necessity for the railway, without which it could not maintain itself as a going plant.[123]

An irrigation or ditch company, though it partakes somewhat of a public utility corporation, is not to be classed with railroads in the matter of preferential liens, but the same rule applies to such companies as to private trading corporations.[124]

§ 606a. There are, however, two cases adopting the opposite view, one decided in Alabama[125] and the other in Mississippi.[126] In the former it is said: "The fact that the corporation is of a public character does not enter into it, and is not an element of it any more than such fact would be necessary to a recovery in trover for a horse converted by a corporation. Every element of this equity may exist as well against a private as against a public corporation, and against bond creditors of the one as well as the other. The right to be asserted is obviously the same, whatever the character in this respect of the corporation. The wrong done to the employes is the same,—the misappropriation of the fund for the payment of their wages. And the remedy for the effectuation of the right and the redress of the wrong is applied upon considerations which take no account of whether the corporation whose earnings have thus been wrongfully diverted from the payment of its employes is a railroad company or a mining company."

[122] Security Trust Co. v. Goble R. Co. 44 Or. 370; 74 Pac. 919; 75 Pac. 697.

[123] Illinois &c. Bank v. Ottumwa Elec. R. Co. 89 Fed. 235.

[124] Hanna v. State Trust Co. 70 Fed. 2; Belknap Sav. Bank v. Lamar &c. Co. 28 Colo. 326; 64 Pac. 212.

[125] Drennen v. Mercantile &c. Co. 115 Ala. 592; 23 So. 164; 39 L. R. A. 623; 67 Am. St. 72.

[126] Le Hote v. Boyet, 85 Miss. 636; 38 So. 1.

§ 606b. In determining what is to be classed as a railway receivership, the public benefit from the operation of the property is the test. A proceeding for the appointment of a receiver for a coal and iron company which operated a short railroad line in connection with its mines should not be treated as a railroad receivership, as it lacked the essential element, namely, that of maintaining the operation of the road for the benefit of the public. Consequently, in such a receivership, no preferential liens could be declared.[127]

§ 607. If there is no income in the receiver's hands after paying the running expenses of the road, claims against the corporation cannot be declared liens against the property, unless it be shown that current earnings of the corporation have been used for the benefit of the mortgage creditors. If there has been no loan, use, or application, claims for wages or expenses can only be paid from any surplus that may remain after the full satisfaction of the debts of the mortgage creditors.[128] "We do not hold," said Chief Justice Waite in Burnham v. Bowen,[129] "any more than we did in Fosdick v. Schall[130] or Huidekoper v. Locomotive Works,[131] that the income of a railroad, in the hands of a receiver for the benefit of mortgage creditors who have a lien upon it under their mortgage, can be taken away from them and used to pay the general creditors of the road. All we then decided and all we now decide is, that if current earnings are used for the benefit of mortgage creditors before current

[127] Manhattan Trust Co. v. Seattle Coal &c. Co. 19 Wash. 493; 53 Pac. 951.

[128] United States Trust Co. v. New York &c. R. Co. 25 Fed. 800; Mersick v. Hartford &c. R. Co. 76 Conn. 11; 55 Atl. 664; 100 Am. St. 977; Cutting v. Tavares &c. R. Co. 61 Fed. 150. The same principle has been applied to a gas company. Hunt v. Memphis Gaslight Co. 95 Tenn. 136; 31 S. W. 1006.

[129] 111 U. S. 776, 783; 4 Sup. Ct. 675. In this connection the distinction between receivership expenses and claims for supplies furnished prior to the receivership, must be kept constantly in mind. As a general rule preferential liens for supply bills incurred prior to the receivership only extend to current income. Still many declarations to the contrary are found in the cases. See New York &c. Co. v. Tacoma R. &c. Co. 83 Fed. 365; Cleveland &c. Co. v. Knickerbocker Trust Co. 86 Fed. 73; Farmers' &c. Co. v. Kansas City &c. R. Co. 53 Fed. 182; Atlantic Trust Co. v. Woodbridge &c. Co. 79 Fed. 39.

[130] 99 U. S. 258.

[131] 99 U. S. 235.

expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use."

If there are no earnings, equitable liens payable out of earnings only cannot be paid from the proceeds of the property sold after the mortgage bonds.[132] When foreclosure takes place, no one can compete with the mortgagee in the distribution of the proceeds of the property. It is only the income of the property while it is under the administration of the court that is subject to the direction of the court, for the payment of unsecured claims which the court may deem entitled to an equitable priority. Such income is regarded as a fund produced by the administration of the court, and which, therefore, may be applied as the court may in its equitable discretion direct.[133]

In case there is no income in the hands of the receiver to pay such equitable claims, and there is likely to be a long delay before payment can be made from such income, the court may authorize the receiver to issue certificates of indebtedness to the holders of such claims, bearing interest and made payable out of funds applicable to such purpose, at such dates as may afterwards be fixed by the receiver.[134]

While ordinarily the power of the court to direct the payment by the receiver of privileged debts is confined to the appropriation of the income of the receivership and the proceeds of the mortgaged assets that have been taken from the company, cases may arise that will require the use of the proceeds of the sale of the mortgaged property in the same way; as when, before the appointment of the receiver, or in the administration of the cause, income applicable to the payment of old debts for current expenses is taken and used to make permanent improvements in the fixed property, or to buy additional equipment.[135]

[132] Blair v. St. Louis &c. R. Co. 25 Fed. 232; Hand v. Savannah &c. R. Co. 17 S. C. 219, 270.

[133] Taylor v. Phila. &c. R. Co. 7 Fed. 377; International Trust Co. v. T. B. Townsend, &c. Co. 95 Fed. 850; 37 C. C. A. 396. But see contra, Lee v. Pennsylvania Traction Co. 105 Fed. 405.

[134] Taylor v. Phila. &c. R. Co. 7 Fed. 377.

[135] Thomas v. Peoria &c. R. Co. 36 Am. & Eng. R. Cas. 381, per Harlan, J.; St. Louis &c. R. Co.

§ 608. The court may in its discretion order a receiver to pay a tax upon the franchise of a railroad company out of the gross earnings of the company in his hands, especially in case the mortgage, the foreclosure of which is sought, exceeds the value of all the property. Such a tax is probably not in a strict and technical sense a lien upon any specific property of the corporation. But the state in such case is regarded as having a paramount right to collect such tax before the moneys applicable to its payment shall be paid away by the receiver. The receiver in operating the road uses the franchise conferred by the state upon the company, and uses it as an officer of the court which is administering the affairs of the company, until, by virtue of the legal proceedings, the receiver is discharged, and the road returned to the corporation, or other proceedings are taken under a reorganization.[136]

Taxes upon property are generally made a lien thereon, and in such case the taxes upon the property of a railroad in the custody of the law are a lien prior to all other liens except that for judicial costs.[137]

There is no exemption of property in the hands of a receiver from the operation of the tax laws of the government within whose jurisdiction such property is situated. Receivers having been appointed pending a suit for the foreclosure of a railroad mortgage, they applied to the court to enjoin tax collectors from executing warrants for taxes assessed on the mortgaged property, on the ground of irregularities in the assessment of the taxes; but, the warrants appearing to be regular, and the collectors acting in good faith in the discharge of their duty, the court refused to enjoin them.[138]

v. Cleveland &c. R. Co. 125 U. S. 658; 8 Sup. Ct. 1011; United States Trust Co. v. New York &c. R. Co. 25 Fed. 797; Miltenberger v. Logansport R. Co. 106 U. S. 286; 1 Sup. Ct. 140; Easton v. Houston &c. R. Co. 38 Fed. 12; Southern R. Co. v. Carnegie Steel Co. 170 U. S. 257; 20 Sup. Ct. 347; 76 Fed. 492; Southern R. Co. v. American Brake Co. 76 Fed. 502.

[136] Central Trust Co. v. New York &c. R. Co. 110 N. Y. 250; 18 N. E. 92; 1 L. R. A. 260.

[137] Georgia v. Atlantic &c. R. Co. 3 Woods (U. S.), 434.

[138] Stevens v. New York &c. R. Co. 13 Blatchf. (U. S.), 104.

Judge Blatchford, rendering the decision of the court, said: "There is no prerogative of sovereignty which is of higher importance than the power of taxation, which includes the collection as well as the

§ 609. Debts payable out of principle when there has been a diversion of income. If current earnings are used for the benefit of mortgage creditors before claims for current expenses are paid, the *corpus* of the mortgage security, or the fund realized from the sale of it, is in equity chargeable with the restoration of the fund thus diverted.[139] In the leading case of Fosdick v. Schall, it was said that provision may be made for a restoration, from the proceeds of sale, of the fund that has been diverted, because in equity the diversion created a charge on the property against those for whose benefit it had been made. The subsequent cases have reaffirmed the same view. In Miltenberger v. Logansport Ry. Co., Mr. Justice Blatchford said: "Many circumstances may exist which may make it necessary and indispensable to the business of the road, and the preservation of the property, for the receiver to pay preexisting debts, of certain classes, out of the earnings of the receivership, or even the *corpus* of the property, under the order of the court, with a priority of lien. Yet the discretion to do so should be exercised with very great care. The payment of such debts stands, *prima facie*, on a different basis from the payment of claims arising under the receivership, while it may be brought within the principle of the latter

assessing of the taxes. The very existence of the state as a government depends upon the exercise of such power. Except under very special circumstances, such power ought not to be interfered with by injunction. If any person is aggrieved by the exercise of the authority of the tax-collector, he has an adequate ultimate remedy in an action against the wrongdoer, with the preliminary remedy afforded of directly reviewing the proceedings according to the method, and before the tribunal, provided by the laws of the government under whose authority the proceeding takes place."

[139] Burnham v. Bowen, 111 U. S. 776, 783; 4 Sup. Ct. 675; 17 Am. & Eng. R. Cas. 308; Fosdick v. Schall, 99 U. S. 235; Miltenberger v. Logansport R. Co. 106 U. S. 286, 311; 1 Sup. Ct. 140; Union Trust Co. v. Illinois &c. R. Co. 117 U. S. 434; 6 Sup. Ct. 809; Union Trust Co. v. Morrison, 125 U. S. 591; 8 Sup. Ct. 1004; Wood v. Guarantee Trust &c. Co. 9 Sup. Ct. 131; St. Louis &c. R. Co. v. Cleveland &c. R. Co. 125 U. S. 658; 8 Sup. Ct. 1011; 33 Am. & Eng. R. Cas. 16; United States Trust Co. v. New York &c. R. Co. 25 Fed. 797, 800; Easton v. Houston &c. R. Co. 38 Fed. 12; Farmers' &c. Co. v. Vicksburg &c. R. Co. 33 Fed. 778; Calhoun v. St. Louis &c. R. Co. 9 Biss. (U. S.) 330; Finance Co. v. Charleston &c. R. Co. 52 Fed. 524; 48 Fed. 188; Randolph v. Farmers' &c. Co. 91 Tex. 605; 44 S. W. 70.

by special circumstances." In a more recent case Mr. Justice Matthews, referring to the statement of the rule made by Chief Justice Waite in Burnham v. Bowen, which is followed in the text above as the rule governing all the cases, said there had been no departure from his rule in any of the cases; but that it had been adhered to and reaffirmed in them all.[140]

"There are cases," he further said, "when, owing to special circumstances, an equity arises in favor of certain classes of creditors of an insolvent railroad corporation, otherwise unsecured, by which they are entitled to outrank in priority of payment, even under a distribution of the proceeds of a sale of the body of the property, those who are secured by prior mortgage liens."

If, in a case of a diversion of income, a strict foreclosure is had instead of a sale, the payment of such debts for operating expenses should be charged upon the income of the property that may be received after foreclosure.[141] "As the diversion of the fund created in equity a charge on the property as security for its restoration, it is clear that, if the mortgagees prefer to take the property under a decree of strict foreclosure, they take it subject to the charge in favor of the current debt creditor whose money they have got, and that he can insist on a sale of the property for his benefit if they fail to make payment without."[142]

§ 609a. **That there must be a diversion of income in order that operating expenses prior to the receivership may be a prior lien against the corpus** of the property has been reaffirmed by a recent case[143] in the Supreme Court but by a divided court. This case stands as one in which there has been no diversion of income by which the mortgagees profited, and the main question was the general one, whether in such a case a claim for necessary supplies furnished within six months before the receiver was appointed, should be charged

[140] St. Louis &c. R. Co. v. Cleveland &c. R. Co. 125 U. S. 658, 673; 8 Sup. Ct. 1011.

[141] Burnham v. Bowen, 111 U. S. 776, 782; 4 Sup. Ct. 675. In giving the decree the court saved the rights of all intervenors, and continued the case for the final determination of their rights.

[142] Burnham v. Bowen, 111 U. S. 776, 782; 4 Sup. Ct. 675, per Waite, C. J.

[143] Gregg v. Metropolitan Trust Co. 197 U. S. 183; 25 Sup. Ct. 415.

on the *corpus* of the fund. There were no special circumstances affecting the claim as a whole, and if it was charged on the *corpus*, it could only be by laying down a general rule that such claims for supplies were entitled to precedence over a lien expressly created by a mortgage recorded before the contracts for supplies were made. The doctrine of the majority of the judges was that such a rule could not be laid down, and the preferential lien was not allowed.

The claim or lien of employes for work performed within six months of the receivership has priority and is enforceable to the extent that their work or services contributed to the permanent improvement or betterment of the mortgaged property, or in so far as the gross earnings of the corporation have been diverted from the payment of wages and paid to the bondholders. Such is the rule which the Supreme Court of Alabama deduced from the authorities in 1897.[144] And the same court declared shortly afterwards that the equity of an employe to have his claim preferred does not arise out of the bare fact that a few of the claimants rendered services as mechanics, motormen or conductors within a certain period; it is necessary to show a diversion of income or permanent improvements inuring to the benefit of bondholders.[145]

By the Texas statute the only claims made liens on the property in the hands of the receiver superior to the mortgage lien are judgments rendered for causes of action arising during the receivership. Claims arising prior thereto are limited to a preference lien on the moneys coming into the hands of the receiver as the earnings of the property in his hands. Without net earnings, therefore, no provision is made for their payment.[146]

§ 610. Limit of time within which preferred debts must have been incurred.—The equitable lien in favor of creditors who have furnished labor and supplies is not allowed to extend back for a longer period than six months, except under extraordinary circumstances. In fixing this period the courts recognize the principle

[144] Drennen v. Mercantile &c. Co. 115 Ala. 592; 23 So. 164; 39 L. R. A. 623; 67 Am. St. 72.

[145] Pickering v. Townsend, 118 Ala. 351; 23 So. 703.

[146] Ellis v. Vernon Ice Co. 4 Tex. Civ. App. 66; 23 S. W. 856, construing Sayles' Civ. St. Art. 1470d, 1470e, Add. 1466.

that the extent to which this class of claims is to run back is to be measured by the usual course of credit and business of the company in the conduct of its affairs; that is, the usual term of credit upon which companies have purchased their supplies, or settled, as in the case of railroads, with their connecting lines, is taken as the measure of the period within which this class of claims shall be protected.[147] The six months' limitation is not an inflexible rule and the court may reserve to itself the right to allow a longer time, but there should be some special equity to grant an extension beyond a twelve months' period.[148]

In fixing the period within which such claims are protected, the courts have sometimes said that they will adopt by analogy the rule of the state statutes in relation to liens on railroads for work done and materials furnished.[149]

It has also been said that in respect to the length of time there is no definite rule, but the time is fixed in each case within the discretion of the court.[150]

If from lapse of time or from other circumstances, the debt for equipment or labor sought to be preferred by order of the court and to be paid out of the earnings of the receivership, is more properly to be classed with the general debts of the corporation than with those incurred for current expenses proximately connected with the possession and operation of the road by the receiver, it is a proper exercise of the discretion of the court to disallow the application.[151]

[147] Reyburn v. Consumers' &c. Co. 29 Fed. 561, per Blodgett, J.; Dow v. Memphis &c. R. Co. 20 Fed. 260; Farmers' &c. Co. v. Vicksburg &c. R. Co. 33 Fed. 778; Olyphant v. St. Louis &c. Co. 22 Fed. 179; Blair v. St. Louis &c. R. Co. 22 Fed. 471; Kelly, In re, 5 Fed. 846; Scott v. Clinton &c. R. Co. 6 Biss. (U. S.) 529; Central Trust Co. v. East Tennessee V. & G. Ry. Co. 80 Fed. 624; 26 C. C. A. 30; International Trust Co. v. T. B. Townsend &c. Co. 95 Fed. 850; 37 C. C. A. 396.

[148] State Trust Co. v. Kansas City &c. R. Co. 129 Fed. 455, holding a claim for cost of air brakes required by Act of Congress did not have a sufficient special equity to change the general rule.

[149] Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 315.

[150] Railroad Co. v. Lamont, 69 Fed. 23; 16 C. C. A. 364; New York &c. Co. v. Tacoma R. &c. Co. 83 Fed. 365.

[151] Manchester Locomotive Works v. Truesdale, 44 Minn. 115; 46 N. W. 301; 9 L. R. A. 140n.

§ 610a. Loss of preferential lien by laches.—Where supplies are furnished shortly before a receivership, delay to interpose a claim until after mortgage creditors have instituted foreclosure proceedings will not bar a recovery if there are still assets from which the claims may be paid. Delay of the receivers to make payment is the delay of the court, against which a claimant will be protected when practical. In any event a court could not cut off in a summary manner the equities of a petitioner who is not a party to the proceeding.[152]

But failure to intervene in a receivership for six years after a claim entitled to a preference accrues, bars the claimant to a preference on the ground of laches, the receivership being a notorious and widely known proceeding.[153] The length of delay in asserting one's rights which will amount to laches, is not subject to fixed rule but is largely dependent upon circumstances. Upon principle in the absence of special circumstances, a party should be entitled to equitable relief for the full period in which, according to the statute, an action might be maintained at law to enforce the demand.[154]

§ 611. Where persons furnished supplies from time to time under a continuous verbal contract made after default in the payment of the company's bonded interest, during a period of more than two years until a receiver was appointed, it was held that they were entitled to a lien for the supplies so furnished superior to that of the mortgage creditors, payable out of the earnings in the receiver's hands. The reason given for this is, that if the mortgagee, instead of enforcing his rights, elects to have the corporation operate the road, he must be considered in equity as estopped from disputing that such operations were for his benefit, and to be accounted for in the final adjustment of the rights of all concerned. The contract, moreover, might be regarded as incomplete until the appointment of a receiver, and consequently as falling within the equitable rule.[155]

[152] New England R. Co. v. Carnegie Steel Co. 75 Fed 54.

[153] Stewart v. Wisconsin Cent. R. Co. 95 Fed. 577.

[154] Bellingham &c. Co. v. Fairhaven R. Co. 17 Wash. 371; 49 Pac. 514.

[155] Blair v. St. Louis &c. R. Co. 22 Fed. 769. See United States Trust Co. v. New York &c. R. Co. 25 Fed. 797.

As a general rule, however, a mortgagee by refraining from taking action upon a default does not make the mortgagor his agent to incur debts, nor does he impliedly consent that debts incurred subsequently to the default shall take precedence over the mortgage debt.[156]

§ 611a. **Right to apportionment of preferential debts.**—A preferential indebtedness incurred by a receiver of a consolidated line, which receivership is obtained by a mortgagee of the consolidated properties, cannot be apportioned among the several mortgage interests on separate divisions of the road. The mortgagee of the consolidated line cannot require an accounting between the several constituent lines of receipts and disbursements during the receivership. The consolidated mortgagee having a junior lien and having procured the receivership in its own interest, the debt thereby created is primarily a charge upon its interest in the property. A payment of interest on prior divisional mortgages would not give rise to a right of apportionment, because such interest payments are paid to prevent a foreclosure of the divisional mortgages and inure to the benefit of the security.[157] But apart from the question of priority, a court has discretion to apportion receivership expenses among subsidiary lines operated by the receiver.[158]

§ 611b. **Prosecuting an action against a railway to final judgment does not forfeit a preferential lien,** when such suit was commenced before an action to foreclose the mortgage. The claimant retains the same right after the recovery of judgment as before, to insist that in the forum of equity, and in the distribution of the proceeds, his demand should be preferred. But he has no standing in court to maintain his claim to a preference without going behind the judgment, and showing the origin and nature of the demand on which the judgment rests.[159]

§ 611c. **A claim for a preferential lien must be presented in a**

[156] Blair v. St. Louis &c. R. Co. 22 Fed. 471.

[157] New York &c. Co. v. Louisville &c. R. Co. 102 Fed. 382. See, also, supra, § 605.

[158] Pennsylvania Co. v. Jacksonville &c. R. Co. 66 Fed. 421.

[159] Central Trust Co. v. Clark, 81 Fed. 269.

petition for intervention and not by motion. Holders of claims who do not come within the terms of a general order requiring receivers to pay claims for labor and supplies accruing within six months, have no standing to file a motion for payment of their claims in full, and can only be heard upon a petition of intervention setting out the facts on which their claims to preferential payment is based according to the rules of pleading.[160]

§ 611d. Since railway corporations cannot sell, lease or mortgage their property without legislative consent, the legislature may couple with the grant of those powers such conditions and limitations as it chooses to impose. Hence a proviso prohibiting railways from giving a mortgage which shall be binding against judgments for timber furnished and work and labor done, or for damages done to persons and property in the operation of the road, is valid, and the Tennessee statute to such effect was sustained.[161]

The Kentucky lien law, under the liberal rule of construction in force in that state, has been held to include a street railroad under the terms "canal, railroad, turnpike, or other public improvement." A street railroad is at least a public improvement, and is as fully within the purview and spirit of the act as a railroad or turnpike would be, and consequently a lien upon it would by force of the statute be entitled to priority of payment over an outstanding mortgage.[162]

Under the Iowa lien statute[163] it has been held that a terminal company is a railway company within the meaning of the statute, and where the building of a union depot was the central purpose of its organization, a lien for work and materials employed in its construction would be entitled to priority over a prior mortgage.[164]

The Virginia railroad lien law has been construed to include engines used to generate electric power to run an electric road. The time for filing claims specified begins to run as soon as the engines are installed and made ready for operation.[165]

[160] Grand Trunk R. Co. v. Central Vermont R. Co. 91 Fed. 561.

[161] Frazier v. Railway Co. 88 Tenn. 138; 12 S. W. 537.

[162] Montgomery v. Allen, 107 Ky. 298; 53 S. W. 813.

[163] McLain's Ann. Code, ch. 8.

[164] Beach v. Wakefield, 107 Iowa, 567; 76 N. W. 688; 78 N. W. 197.

[165] Frick v. Norfolk &c. R. Co. 86 Fed. 725.

§ 611e. **A mere right to file a mechanic's lien against a railway company under a state statute does not preclude the assertion of an equitable lien** under the receivership according to the better view. The Missouri Court of Appeals[166] reached the opposite conclusion, relying on the ground that the remedy by filing a mechanic's lien antedated the doctrine of preferential lien in equity, and that an existing legal remedy ousted equity jurisdiction. The right of supply claimants to an equitable lien in certain contingencies, upon the mortgaged property of a railroad in the course of administration in the courts, first received the assent of the federal judiciary in October, 1878. This doctrine had received no recognition when the policy of the Missouri legislature, to create a mechanic's lien for such a claim, was manifested by the Session Acts of 1873, p. 58. Upon this state of the law, declare the court, the claimants' rights should have been set up in conformity with the statutes of the state applicable to the enforcement of mechanic's liens against railroads, and he cannot assert a preferential lien in the receivership suit. The answer to these arguments is that the equity principles by which a preferential lien is given existed prior to 1878, and that the remedy did not originate at that time, but that the court was then first called upon to apply such principles to an existing controversy.

In a case arising in the Federal Court for the Western District of Missouri[167] the court refused its assent to the doctrine of the local courts, not being bound because the Court of Appeals was not a court of last resort. In the federal case under discussion the question involved was whether filing a claim under a local lien law precluded a creditor from a preferential lien at equity, and the court held that it did. Filing the lien claim under the statute was a proclamation in solemn form by the claimant to the receivers and every creditor of the insolvent company that it abandoned any other assertion of a lien, especially an equitable one dependent upon a different state of facts. The analogy on which the court rested its decision is the rule that claiming a statutory lien excludes all claims under a common law lien.[168]

[166] Van Frank v. St. Louis &c. R. Co. 89 Mo. App. 573; Van Frank v. Brooks, 93 Mo. App. 412; 67 S. W. 688.

[167] State Trust Co. v. Kansas City &c. R. Co. 129 Fed. 455.

[168] Vane v. Newcombe, 132 U. S. 220, 238; 10 Sup. Ct. 60; 33 L. Ed. 310.

The doctrine of the Missouri Court of Appeals is supported by a Georgia case, so the question must still be regarded as an open one.[169]

III. *Equities under Contracts and Leases made subsequently to Mortgages.*

§ 612. Contracts made by a railroad company subsequently to a mortgage are not binding upon the mortgagees, or upon receivers of the road who are appointed in their behalf, although the contracts relate to the carrying of freight in payment of a loan made to the company. Thus, the Boston, Hartford and Erie Railroad Company, having mortgaged its property to secure certain bonds, entered into a contract with the Adams Express Company, whereby the latter company loaned the former the sum of $200,000, and it was agreed that the sum should be paid by carrying freight for the express company at certain rates. Before this loan was fully repaid, the mortgagees obtained the appointment of receivers, who, after entering upon their trust, gave notice to the express company that they would decline to be bound by the contract. The express company thereupon applied to the court for an order to compel the receivers to carry the freight in accordance with the contract made with the railroad company. The court held, however, that the contract was not binding upon the mortgagees, and that the receivers should disregard the contract, and should recover of the express company compensation for carrying freight, without reference to the terms fixed by the agreement.[170]

[169] Farmers' &c. Co. v. Candler, 92 Ga. 249; 18 S. E. 540.

[170] Ellis v. Boston &c. R. Co. 107 Mass. 1, 17. The court, upon this question, say: "The payment of the debts of the corporation previously contracted would be inconsistent as well with the nature and purpose of the office of the receivers as with the terms of their appointment. They have no right to appropriate the property and assets of the corporation for that purpose, nor the earnings of the road while operated by them. The amounts to be allowed under the contract of the corporation with the petitioners are earnings of the road, to be acquired by services requiring outlays by the receivers, and are a part of its legitimate assets as much as if due in money. By the terms of the contract they are to be applied to the debt of

The question of the right of the mortgagees to the income of the property during the pendency of the foreclosure suit is declared by the court to depend upon the provisions of the mortgage; and the only mode provided by that whereby the trustees may reach and control the use of the corporate property, and appropriate the income of it, being an entry by them into possession, and the filing and recording of written notice of their possession, they cannot acquire any lien upon the income of the road in any other mode. And, therefore, it was held that the lien of the mortgagees attached to the earnings of the road only from the time the trustees were themselves put into possession by the court; that the railroad company having in the mean time been adjudged bankrupt, the income belonged to the assignees from that time until the trustees were put in possession; and that, as to the compensation earned under the contract with the express company prior to the bankruptcy, the express company was bound to pay to the receivers only so much of it as might be required to reimburse the receivers for their expenses and charges, and that the express company could apply the balance to the reduction of the debt of the railroad company to them.

One clause of the mortgage provided that the remedy therein given should not deprive the mortgagees of their full rights and remedies, as they then existed, at law and in equity. "Whether this provision would authorize a foreclosure and sale of the property and franchises of the corporation, for the benefit of the bondholders, without the intervention of the trustees provided for in the mortgage, and whether, in such case, the income, from the time the receivers took possession, would be treated as incident to, and part of, the fund distributable to the mortgagees or bondholders, we need not determine, because these proceedings have not been conducted to that result. The suit having been directed to, and having resulted in possession by the trustees, for the purpose of a foreclosure *in pais*, in pursuance of the provisions of the mortgage first quoted, the ef-

the corporation. But that contract constitutes no lien upon the property or franchise of the corporation; and it is no more obligatory upon the receivers either to make the application or to render the service than the debt itself is. To fulfill that contract in all its terms will be, in substance and effect, to appropriate the use of the property and the earnings of the road, pro tanto, to the payment of the debt to the petitioners in preference to all others."

fect upon the rights of all parties must be determined accordingly. The lien of the mortgagees attaches to the income only from the time of thus taking possession of the corporate property and franchises."

A lease providing that net earnings are to be paid to bondholders of the lessor, operates as an assignment of these accruing net earnings to such bondholders after they have assented to it, and is then irrevocable. So the lessor and lessee could not subsequently control the disposition of these net earnings, without reference to the claims of the bondholders, although the latter were not parties to the lease.[171]

§ 613. There is no legal principle by which contracts made by a railroad company, after the execution of a mortgage, without the consent of the mortgagees, and without a positive statute which enters into the mortgage contract, can be made binding upon the mortgagees, or upon receivers appointed in their behalf.[172]

In a recent case before the United States Circuit Court for Virginia, upon a petition that the receivers be ordered to pay certain bills for iron and supplies furnished the company, the court decided that, inasmuch as these claims rested solely upon the credit of the company, they could not be made prior to the mortgages upon the road, and that the petitioners must, therefore, wait until the road is sold, when their claims could be paid out of the surplus, if any, remaining after the mortgage should be satisfied.[173]

Although a receiver is not bound by a contract made by the company after the execution of the mortgage for the enforcement of which the receivership was created, yet, if he ratifies the contract, it seems that the rights under such contract are not affected by the foreclosure proceedings.[174]

[171] Grand Trunk R. Co. v. Central Vermont R. Co. 78 Fed. 690.

[172] Hale v. Nashua &c. R. Co. 60 N. H. 333; Ellis v. Boston &c. R. Co. 107 Mass. 1, 17. A guaranty of tolls was held not binding upon a prior mortgagee in Newport & C. Bridge Co. v. Douglass, 12 Bush (Ky.), 673, 712. See, also, Elmira Iron &c. Co. v. Erie R. Co. 26 N. J. Eq. 284; Tommey v. Spartanburg &c. R. Co. 4 Hughes (U. S.), 640.

[173] Atlantic &c. R. Co. In re, 3 Hughes (U. S.), 320. To same effect, see Denniston v. Chicago &c. R. Co. 4 Biss. (U. S.) 414.

[174] Western Union Telegraph Co. v. Atlantic &c. Co. 7 Biss. (U. S.) 367.

A contract between a railway company and a bridge company, made subsequent to the mortgage, whereby the former company guaranteed that the tolls of the latter company for the use of its bridge across the Ohio River should amount annually to a certain sum, does not affect the rights of the mortgagee, and the bridge company cannot require that the order of sale shall provide that the purchaser shall carry out the terms of this contract.[175]

When another road has, by contract, the right to run over a road in the hands of a receiver, upon the payment of a stipulated rent, and the rent is not paid to the receiver according to the terms of the contract, he may, after proper notice, sever the connection between the roads.[176]

With the consent of the court, the receiver may pay out of the funds in his hands sums collected by the insolvent company in trust for connecting railroad companies, to which the money belonged. The withholding of these moneys would be not only a breach of trust, but would probably result in the refusal of these companies to keep up business relations with the company or its receivers, and in a consequent loss of business to the road; and, therefore, the payment is justifiable as a business measure, to keep up the traffic of the road.[177]

A contract for transportation made by a railroad company before the execution of a mortgage of its property cannot be specifically enforced after the company has become insolvent and its property has been placed in the hands of a receiver, unless the contract is a lien upon the property and the mortgagee had notice of it. It does not matter that the other party to the contract had loaned money to the railroad company, and the latter had agreed to repay it by transporting goods for the lender. A specific performance of the contract would be a form of satisfaction or payment which the receiver could not be required to make.[178]

§ 614. A mortgage made after the execution of a lease of the property by the mortgagor, of which the mortgagee has notice, either

[175] Newport &c. Co. v. Douglass, 12 Bush (Ky.), 673, 712.

[176] Elmira Iron &c. Co. v. Erie R. Co. 26 N. J. Eq. 284.

[177] Meyer v. Johnston, 53 Ala. 237, 353.

[178] Express Co. v. Railroad Co. 99 U. S. 191.

actual or constructive, is of course subject to the obligation of the lease. When a railroad company which has taken a lease of another road afterwards executes a mortgage, a more interesting inquiry arises, whether the mortgagee is bound by the contract of the lease or can question its validity, or foreclose the mortgage and disregard the contract. If the lease be binding upon the corporation itself, and the mortgage was given in express recognition of the contract and in subjection to it, the mortgagee cannot, any more than the corporation itself, object to the validity of the lease on account of the incapacity of the corporation to make it. A bondholder under such mortgage is necessarily in the same way bound by the contract. Neither can he avoid the effect of the lease in any particular by showing that as between himself and the mortgagor it would be prejudicial and unjust to him to give the contract the effect the parties themselves intended it to have, and which governs as between them. To make his defense effectual he must show that it would be inequitable for the lessor as against him to claim this construction of the lease.[179]

A mortgagee cannot obtain an appointment of a receiver against a lessee whose lease is prior in date to the mortgage. Allegations of extravagance and bad management by the lessee entitle the mortgagee to an accounting but not to a receivership.[180]

§ 615. A landowner's claim for damages for land taken for the road is paramount to a mortgage given before the damages have been assessed;[181] and the appointment of receivers of the company pending proceedings in another court against the company for the assessment of land damages does not interfere with the prosecution of such proceedings, nor is the plaintiff bound to bring in the receiver. It is their business to intervene, if they wish to do so.[182]

Where the constitution of a state provides that compensation for property taken for public use shall be paid or secured before such taking, the owner has an estate in land taken rather than a lien upon it; and, therefore, if land be taken by a railroad company

[179] Vermont &c. R. Co. v. Vermont Central R. Co. 34 Vt. 1.

[180] Louisville &c. R. Co. v. Eakins, 100 Ky. 745; 39 S. W. 416.

[181] Western Pennsylvania R. Co. v. Johnston, 59 Pa. St. 290.

[182] Mercantile Trust Co. v. Pittsburgh &c. R. Co. 29 Fed. 732.

without paying or securing the owner, and the company becomes insolvent and its property and franchises are sold under a prior mortgage, the sale does not divest the estate of the owner of land so taken, but he may recover the amount of a judgment for damages against the purchaser at such foreclosure sale.[183] If the railroad company had given a bond to pay the damages before taking the property, the company could give a purchaser a good title to such land, and the owner would be thrown back upon this security for his damages.[184]

[183] Buffalo &c. R. Co. v. Harvey, 107 Pa. St. 319; Philadelphia &c. R. Co. v. Cooper, 105 Pa. St. 239.

[184] Fries v. Southern &c. Co. 85 Pa. St. 73.

CHAPTER XIX.

SCHEMES FOR REORGANIZATION AFFECTING THE PRIORITY OF MORTGAGES.

I. Rights under agreements for reorganization, §§ 616–623.

II. Rights of preferred stockholders as against mortgagees, §§ 624–633.

I. *Rights under Agreements for Reorganization.*

§ 616. Schemes for reorganizing corporations.—In general the rights of secured creditors cannot be varied without their consent. It often happens, however, that such creditors are in effect compelled to admit unsecured creditors and the stockholders of an insolvent company to come into a scheme for its reorganization and share in its benefits in some degree. It is sometimes so far within the power of the stockholders and unsecured creditors to embarrass and delay proceedings for the foreclosure of the mortgage and sale of the property that it is expedient for the mortgage creditors to arrange for a reorganization, and give up something of their own security, for the sake of avoiding litigation and delay.[1]

The entering into a scheme of reorganization is a voluntary matter with creditors or stockholders of a corporation. It cannot be forced upon any one except by virtue of a statute existing prior to the charter of the corporation, so that such statute becomes a part of the contract under which its securities and stock were issued.[2]

[1] Mackintosh v. Flint &c. R. Co. 34 Fed. 582, 591, quoting text; 36 Am. & Eng. R. Cas. 340.

[2] By force of statutory provisions for reorganization, the rights of secured creditors may be varied with-

But provisions in behalf of subordinate interests cannot be said to be made without consideration, because they are voluntary concessions on the part of those who hold prior interests. The courts will give effect to compromise agreements.[3] "Such concessions," said Mr. Justice Strong,[4] "are generally made in reorganizations of railroad companies, and they are regarded as beneficial to the joint lien-holders. They prevent delay and expenditures arising out of litigation between creditors, which are sometimes almost ruinous, and they lessen the risk of redemptions."

Where a plan of reorganization has received the assent of a majority of the bondholders, but a minority has dissented, and asked to be made parties, on the ground that they are discriminated against unjustly, and that the trustee has espoused the interests of the majority, and has allowed improper charges to be made by the receiver for compensation and for expenditures, such minority bondholders

out their consent. Thus the Railway Companies Act of England provides, "where a company are unable to meet their engagements with their creditors, the directors may prepare a scheme of arrangement between the company and their creditors, with or without provisions for settling and defining any rights of shareholders of the company as among themselves, and for raising, if necessary, additional share and loan capital, or either of them, and may file the same in the Court of Chancery for England or in Ireland, according to the situation of the principal office of the company, with a declaration in writing, under the common seal of the company, to the effect that the company are unable to meet their engagements with their creditors." The scheme must be assented to by three fourths of the mortgagees and holders of bonds, debenture stock, and preference stock respectively affected by it, and when so assented to may be confirmed by the Court of Chancery. But in such statute becomes a part of the contract under which subsequent securities are taken. The authority of parliament in respect to existing corporations is, however, different from that possessed by legislatures in this country. 30 & 31 Vict. 127, §§ 6–16, Act of 1867. Instances of such schemes may be found in London Financial Asso. v. Wrexham &c. R. Co. L. R. 18 Eq. 566; Bristol &c. R. Co. In re, L. R. 6 Eq. 448; Devon & S. R. Co. In re, L. R. 6 Eq. 610; 6 Eq. 615; Cambrian R. Co.'s In re Scheme, L. R. 3 Ch. 278; Munns v. Isle of Wight R. Co. L. R. 8 Eq. 653; Stevens v. Mid-Hants R. Co. L. R. 8 Ch. 1064.

[3] Mackintosh v. Flint &c. R. Co. 34 Fed. 582, 591; 36 Am. & Eng. R. Cas. 340.

[4] Sage v. Railroad Co. 99 U. S. 334, 344.

may be allowed to become parties so far as to permit an examination of such charges.[5]

§ 617. In England and Canada, where there is no constitutional prohibition against laws impairing the obligation of contracts, legislative authority may be given to an embarrassed railway corporation to make an arrangement with its mortgage creditors for the substitution of a new security in the place of the existing mortgage, and to provide that the arrangement shall be binding on all the holders of obligations secured by the same mortgage when it shall have received the assent of the majority. In England there is a general act providing for such arrangements,[6] and in Canada special acts are passed as occasion requires.[7]

[5] De Betz's Petition, 9 Abb. N. C. (N. Y.) 246.

[6] Railway Companies Act, 1867, 30 & 31 Vict. ch. 127; Cambrian R. Co.'s Scheme, L. R. 3 Ch. 278, 294; though special acts are passed whenever they are needed; London Financial Asso. v. Wrexham &c. R. Co. L. R. 18 Eq. 566.

[7] Jones v. Canada Cent. R. Co. 46 Up. Can. Q. B. 250, where Osler, J., said: "Our statute books are full" of such legislation.

Chief Justice Waite, delivering judgment in Canada So. R. Co. v. Gebhard, 109 U. S. 527, 535; 3 Sup. Ct. 363, a case involving the effect of a special act of this kind passed in Canada, said: "It seems to be eminently proper that, where the legislative power exists, some statutory provision should be made for binding the minority in a reasonable way by the will of the majority; and unless, as is the case in the states of the United States, the passage of laws impairing the obligation of contracts is forbidden, we see no good reason why such provision may not be made in respect to existing as well as prospective obligations. The nature of securities of this class is such that the right of legislative supervision for the good of all, unless restrained by some constitutional prohibition, seems almost necessarily to form one of their ingredients; and when insolvency is threatened, and the interests of the public as well as creditors are imperilled by the financial embarrassments of the corporation, a reasonable 'scheme of arrangement' may, in our opinion, as well be legalized as an ordinary 'composition in bankruptcy.' In fact, such 'arrangement acts' are a species of bankrupt acts. Their object is to enable corporations created for the good of the public to relieve themselves from financial embarrassments by appropriating their property to the settlement and adjustment of their affairs, so that they may accomplish the purposes for which they were incorporated."

A scheme of reorganization authorized by the parliament of Canada, for a corporation existing under its laws, is binding upon bondholders who are citizens of the United States who sue in the courts of the United States to recover on their bonds. Such corporation is subject to the control of the laws of the country under which it was created, and any person dealing with such corporation, or investing in its securities, impliedly subjects himself to the laws of that country so far as these affect the powers and obligations of such corporation. Anything done in that country which discharges the corporation from liability there, discharges it everywhere.[8]

§ 618. The rights of bondholders under the mortgage cannot be impaired without their consent by any scheme of reorganization. The bondholders may stand upon their rights under the mortgage, and they are entitled to have their contract rights under the mortgage enforced. They are not obliged to enter a scheme of reorganization, and not entering it, they retain all their rights. "In the absence of statutory authority, or some provision in the instrument which establishes the trust, nothing can be done by a majority, however large, which will bind a minority without their consent."[9] A scheme of reorganization, to be wholly effective, must either be made with the consent of all the original bondholders, or it must be made after a foreclosure which has cut off all liens of such bondholders upon the property.[10]

[8] Canada So. R. Co. v. Gebhard, 109 U. S. 527, 539; 3 Sup. Ct. 363. "Unless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to have legalized, the scheme may fail. All home creditors can be bound. What is needed is to bind those who are abroad. Under these circumstances the true spirit of international comity requires that schemes of this character, legalized at home, should be recognized in other countries. The fact that the bonds made in Canada were payable in New York is unimportant, except in determining by what law the parties intended their contract should be governed; and every citizen of a country other than that in which the corporation is located may protect himself against all unjust legislation of the foreign government by refusing to deal with its corporations."

[9] Canada Southern R. Co. v. Gebhard, 109 U. S. 527, 535; 3 Sup. Ct. 363, per Waite, C. J. See, also, Anthony v. Campbell, 113 Fed. 212.

[10] Hollister v. Stewart, 111 N. Y. 644; 19 N. E. 782.

The consent of a bondholder in his individual capacity is not implied from the fact that he was a member of the board of managers of the corporation at the time the board recommended a scheme of reorganization. Though such bondholder dissented from the scheme, and as a manager voted against it, the fact that he did not publish notice of his dissent as a member of the board did not estop him to enforce his bond against the corporation. The scheme was binding upon such bondholder only so far as it was accepted by him in his individual capacity.[11]

A compromise of claims by a majority of bondholders does not prejudice the rights of the minority, who do not assent, nor prevent the court, through its receivers, from enforcing for their benefit any rights against delinquent stockholders.[12]

A court of equity will not, at the suit of a corporation, compel its minority bondholders to assent to a reorganization scheme by which they are required to scale down their bonds, the benefits of the plan inuring solely to the stockholders.[13] But after bondholders have entered into an agreement for reorganization and deposited their bonds with a committee, the will of the majority governs, as expressed by vote at a regular meeting.[14]

§ 618a. Combinations for purchasing at foreclosure sale favored by courts.—From the vastness of the properties involved, and of the sums necessary to buy them in at decretal or foreclosure sales, the courts have favored combinations of those interested in the property as bondholders or stockholders, organized to buy in the property, for the reason that by this means only are bidders assured, and the best interests of those having claims upon the property protected[15] But the trustee under the mortgage could not create a pool for buying in the mortgaged property at the least possible price for the exclusive benefit of a favored and chosen number of the bondhold-

[11] Philadelphia &c. R. Co. v. Love, 5 Railw. & Corp. L. J. 556.

[12] Land Title &c. Co. v. Asphalt Co. 121 Fed. 587.

[13] Lake Street R. Co. v. Ziegler, 99 Fed. 114.

[14] Olcott v. Powers, 60 Hun (N. Y.), 583; 15 N. Y. S. 263.

[15] Reed v. Schmidt, 115 Ky. 67; 72 S. W. 367; 61 L. R. A. 270; Terbell v. Lee, 40 Fed. 40; Carey v. Railway Co. 45 Fed. 438.

ers. All must be afforded a fair opportunity to share on equal terms.[16]

§ 619. **A bondholder who stays out of a reorganized company may maintain an action against it for an accounting** for the property received from the original company. To such a suit, brought in a circuit court of the United States against the reorganized company, a plea by that company that the road is in the hands of a receiver appointed by a chancery court of the state, is not sufficient. The bill is brought to reach the share of the income which the corporation may have received for the plaintiff. It does not touch the possession of the property. The receivership does not stand in the way of such an accounting.[17]

Such action by a bondholder against the trustee for an accounting would lie upon a conveyance by the trustee to a new corporation, after the trustee had himself bid in the property on foreclosure sale under a provision in the trust deed. The amount of the trustee's expenses being unknown, no direct tender by the plaintiff is necessary, but it is sufficient to aver willingness at all times to pay his share of the expenses.[18]

§ 620. **But while a bondholder's rights are not prejudiced by the scheme, he is not entitled to any greater rights** because he has kept out of it and others have entered into it. He can successfully defend against the reorganization as affecting his bonds, but he cannot make the scheme the means of acquiring an undue preference for himself. He cannot claim to stand as if the bonds of the assenting bondholders had been extinguished, and the whole security of the mortgage were devoted to the bonds of the non-assenting bondholders alone. He cannot take advantage of the voluntary sacrifices of the assenting bondholders, and claim payment in full out of a security which was insufficient to pay all the bondholders.[19]

[16] Reed v. Schmidt, 115 Ky. 67; 72 S. W. 367; 61 L. R. A. 270.

[17] Brooks v. Vermont &c. R. Co. 22 Fed. 211.

[18] Zebley v. Farmers' &c. Co. 139 N. Y. 461; 34 N. E. 1067; reversing 63 Hun (N. Y.), 541; 18 N. Y. S. 526.

[19] Hollister v. Stewart, 111 N. Y. 644; 19 N. E. 782; Stevens v. Mid-Hants R. Co. L. R. 8, Ch. 1064; Barry v. Missouri &c. R. Co. 4 Railw. & Corp. L. J. 198.

§ 620a. Where the powers of a corporation reorganization committee are defined and limited by the reorganization agreement, they cannot of themselves change or dispense with an express stipulation of the agreement. The committee are, in a broad sense, trustees for the benefit of the bondholders, and are bound to protect their interest in every way. They have no power to change the agreement without the consent of the bondholders, whose representatives they are. Their powers are defined and limited by the agreement.[20]

§ 620b. In dealing with reorganization agreements, the court will in every case require good faith from the committee representing the bondholders. Thus, a stipulation that a committee might construe the provisions of the agreement, and their construction should be final, and that no member of the committee should be "liable for anything but his own willful misconduct," does not release such committee from an implied undertaking to prepare a plan and submit it to the bondholders before the property is sold under foreclosure. The plan was to be prepared so that the bondholders could act on it and decide whether to act on the scheme or get out. The bondholders had no power to withdraw their bonds until after a plan of reorganization had been prepared and notice thereof given. This right to take the bonds back if they did not like the plan was vital to the bondholders, and hence it was essential to have the plan submitted before a foreclosure sale.[21]

However, the action of a reorganization committee in selling the property to parties, one of whom is alleged to be a creditor of a member of the committee, and the other a client of a member of the committee, does not render the contract of sale void. Such loose and general charges are not sufficient to invoke the equitable rule that a man cannot occupy inconsistent positions. To extend the rule to

[20] Cox v. Stokes, 156 N. Y. 491; 51 N. E. 316, reversing 78 Hun (N. Y.) 331; 29 N. Y. S. 141; United Water Works Co. v. Omaha Water Co. 164 N. Y. 41; 58 N. E. 58, reversing 29 App. Div. 630; 52 N. Y. S. 1151. See, also, Rogers v. New York &c. Co., 134 N. Y. 197; 32 N. E. 27. As to extent of such committee's powers, see Brooks v. Dick, 62 Hun, 622; 17 N. Y. S. 259.

[21] Industrial &c. Trust v. Tod, 180 N. Y. 215; 73 N. E. 7, reversing 93 App. Div. (N. Y.) 263; 87 N. Y. S. 687; 170 N. Y. 233; 63 N. E. 285, reversing 52 App. Div. (N. Y.) 195; 64 N. Y. S. 1093.

such a case would give it a range and scope almost without a boundary.[22]

Stockholders who have had full knowledge of a plan of reorganization, and have given it their approval, are estopped after the reorganization is complete to maintain a suit as owners of the stock on which they did not subscribe, to overthrow the same on the ground of fraud and conspiracy.[23]

The choice and appointment of a committee to act for bondholders are matters in which a few must take the initiative and the others give their assent by vote or silent acquiescence. Hence an allegation that a reorganization committee is self-appointed is of no importance and does not invalidate the reorganization plans, they being valid in other respects.[24]

§ 620c. **Assent by bondholders binds their transferees.** The fact that some holders of mortgage bonds, who have participated in the organization of a new corporation and voted on their bonds, have since transferred them to other parties not bondholders at the time the new company was organized, cannot affect the status of the corporation. The bonds being once voted, are subjected to the consequences of that vote, regardless of whose hands they may subsequently fall into. It is not in the power of a bondholder, participating in the formation of a new corporation, based upon his bonds and others, to destroy the existence of the corporation, once legally formed, by a subsequent transfer of his bonds to third parties.[25]

§ 621. **A substantial departure from the terms of a compromise** agreement, the object of which was to substitute third mortgage bonds for prior liens and debts existing against a corporation, will absolve the parties to an executory agreement from its obligations, and leave them to stand on their original rights under the prior mortgage. Thus, where the agreement signed by a bondholder re-

[22] Brooks v. Dick, 135 N. Y. 652; 32 N. E. 230.

[23] Symmes v. Union Trust Co. 60 Fed. 830.

[24] Cutler v. Iowa Water Works Co. 128 Fed. 505.

[25] Somerset R. Co. v. Pierce, 88 Me. 86; 33 Atl. 772. See, also, Pierce v. Ayer, 88 Me. 100; 33 Atl. 777.

cited that the amount of debts for which a third mortgage was to be substituted was $955,000, and a mortgage authorized and executed to carry out the agreement recited that the debt secured by it was $1,200,000, the departure from the agreement was considered sufficient to justify a party to it in refusing to comply with it.[26] The excess is so great as to require explanation. A small increase of the amount, arising from an accidental omission of a debt which the agreement was intended to provide for, might not invalidate the agreement. But when the excess is so material, and the only explanation of it is that the mortgage was increased in order to raise funds to enable the company to so construct its road as to form a new connection with another railroad,—an object foreign to the purpose of the compromise agreement,—the change cannot be justified. The fact that the whole amount of $1,200,000 had not been issued under the mortgage is immaterial so long as the corporation had the right to issue bonds to that amount.

§ 621a. Failure of bondholders to surrender bonds in accordance with agreement.—A bondholder who has entered into an agreement for the reorganization of a railroad company, and the purchase of the property at a foreclosure sale, is not entitled to the benefits of his agreement if he fails to perform a stipulation on his part to surrender his bonds when requested prior to the sale to trustees appointed to act for the parties to the agreement; especially when the only means provided for the purchase of the road was the bonds held by the signers of the contract. Such bondholder cannot after the sale come in and participate in the benefits of a reorganization, but can claim only the amount of purchase money yielded by the sale.[27]

A bondholder who alone of all those entering into a reorganization agreement detaches matured coupons and receives payment for them from the proceeds of foreclosure sale, is subject to all the equities arising out of the reorganization agreement to which he is a party. A court of equity will not enforce such agreement for his benefit by

[26] Miller v. Rutland &c. R. Co. 40 Vt. 399; 94 Am. St. 413. See Lyman v. Kansas City &c. R. Co. 101 Fed. 636, where four years' silence barred a bondholder's right to object to a modification of a reorganization agreement.

[27] Carpenter v. Catlin, 44 Barb. (N. Y.) 75.

requiring the committee to deliver to him the bonds of the new company until he places himself on an equality with the other bondholders by returning the money collected on the coupons.[28]

§ 622. **A party to an agreement for the reorganization of a company cannot set up its secret agreement with himself,** to the disadvantage of the other parties to it. The Wilmington and Manchester Railroad Company having issued bonds secured by first, second, and third mortgages, desiring to provide additional means for rebuilding and equipping its road, issued a new mortgage for a sum sufficient to retire the three existing mortgages, and provide for the sum desired; and most of the bondholders under the old mortgages came into the agreement, and exchanged their old bonds for the new. The new mortgage secured bonds of three classes: First, preference bonds for which the first mortgage bonds were to be exchanged; second, preference bonds to be used in rebuilding and equipping the road; and third, preference bonds to be used in retiring the second and third mortgage bonds. Default having been made under the new mortgage, the property was sold under a decree of foreclosure, and the proceeds were directed to be applied, first, to the payment of several creditors under the old mortgages, who had not exchanged their bonds; and the balance to the payment of the first preference bonds pro rata, the proceeds being insufficient to satisfy this class in full. A holder of third preference bonds then intervened by petition, alleging that he had exchanged bonds secured by the second and third mortgages for the new bonds, under a separate agreement that, if all the old bondholders did not come into the arrangement, his old bonds should be returned to him, and he should be restored to all his rights under them; and he, therefore, prayed that his old bonds be returned, and that he be paid the amount out of the proceeds of sale as a creditor who had not parted with his prior lien under the old mortgages. But it appearing that the other purchasers of the new bonds had no notice of this private agreement, he had no equity as against them to the relief asked for. Seeking relief in equity, he can obtain it only on equitable principles. The arrangement between the company and the several creditors, for the exchange of their securities, is regarded in equity as a single contract, for the

[28] Fuller v. Venable, 118 Fed. 543.

reason that both the relations of all these creditors with the company, and their relations with each other, entered into its consideration. The equities among the creditors must be satisfied; and against these he cannot set up a secret agreement with the company, giving him an advantage over the other bondholders.[29]

§ 623. **Under a scheme to relieve an insolvent railroad company by allowing all its creditors to share on equal terms** in a mortgage of all its property, a creditor who held its promissory note, with other notes of the corporation as collateral security for this note, was allowed to prove only the amount of the original note against the corporation, because the purpose of the arrangement was to give all the actual creditors, without regard to the nature of their claims or the form of the contract under which they arose, an equal participation in the security afforded by the mortgage.[30] This is very different from the case where the collateral security was a part of a limited amount secured by mortgage, and the company being in liquidation, the creditor had a legal right to avail himself of the benefit of his collateral security by proving the whole of it against the property.

§ 623a. **A trustee for bondholders purchasing at foreclosure under a reorganization scheme,** though entitled to abandon the purchase because of the failure of such bondholders to pay assessments, remains bound by the terms of this trust, where he proceeds to complete the purchase as such trustee.[31]

II. *Rights of Preferred Stockholders as against Mortgagees.*

§ 624. **Questions of priority have sometimes arisen between preferred stockholders and subsequent mortgagees.** What mortgage interest may be paid by a railroad company, before the payment of in-

[29] White, ex parte, 2 S. Car. 469.

[30] Third Nat. Bank v. Eastern R. Co. 122 Mass. 240. In Morris Canal &c. Co. v. Fisher, 9 N. J. Eq. 667, it was doubted whether a debtor's own bond or mortgage, deposited by way of a collateral, could be sold in the market and applied as such.

[31] Indiana &c. R. Co. v. Swannell, 157 Ill. 616; 41 N. E. 989; 30 L R. A. 290.

terest on its preferred stock, must depend on the construction to be given the conditions attached to such stock. Whatever rights attached to it when it was issued continue to adhere to it.[32] If, at the time of its issue, only interest on mortgages then existing was to be paid before interest on preferred stock, subsequent mortgage indebtedness will not affect that stock, nor the legal right of its holders to receive interest before the payment of interest on mortgages given for such subsequent indebtedness. But preferred stockholders would have no preference over subsequent mortgagees in case the stock was issued on such terms that it should be held that interest on all mortgages of the corporation, whether for indebtedness prior or subsequent to the issue of the preferred stock, was first to be paid from the earnings.[33]

Where statutory preferred stock has priority over any subsequently created mortgage or incumbrance, it must have priority over the claims which such subsequently created mortgage would itself have precedence over. It would be an incongruity to say that the stock should have priority over subsequently created mortgages, and of course, therefore, over those claims which would be deferred to such mortgages, where there is one; and yet at the same time to say the preferred stock should have no priority over the same claims when there is no mortgage.[34]

Upon the foreclosure sale of a railroad and a reorganization, preferred stock was issued to the creditors and stockholders of the road, in payment of their interest in the road, and it was declared that the stock was "to be and remain a first claim upon the property of the corporation after its indebtedness." It was held that the indebtedness referred to was not only the subsisting indebtedness, but also all that might thereafter be incurred; and that such stockholders had no prior lien as against subsequent mortgage creditors.[35]

§ 625. Ordinarily preferred shareholders are entitled to have deficiencies of their dividends made up out of the earnings legally

[32] Chaffee v. Rutland R. Co. 55 Vt. 110, 128, quoting text.

[33] Thompson v. Erie R. Co. 42 How. Pr. (N. Y.) 68; 11 Abb. Pr. N. S. 188, per James, J.

[34] Heller v. National Marine Bank, 89 Md. 602; 43 Atl. 800; 45 L. R. A. 438; 73 Am. St. 212.

[35] King v. Ohio &c. R. Co. 9 Biss. (U. S.) 278.

applicable to the payment of dividends, whenever such earnings are received, in preference to any payment to the holders of the common stock. This right is inferred from the contract, and need not be provided for in express terms.[36] The preferred shareholders are entitled to have the full amount of their dividends paid before any payment is made in respect of dividends upon the ordinary stock. Such dividends, in relation to the common stock, are substantially interest chargeable exclusively on profits; yet there is nothing in such a use of the word "dividend" which is at all at variance with the ordinary usage.[37] Such dividends are not payable absolutely or unconditionally, as interest is, but only out of profits made by the company. If there are no dividends, there are no profits. If there were no profits last year, but there are profits this year, the arrears of dividends at the stipulated rate, payable for last year, together with the dividends for this year, are both to be paid if the profits are sufficient for this purpose. The preference is limited to the profits of the company whenever earned.[38] Preferred stockholders do not lose their rights to have arrears of dividends made up to them through laches in asserting their rights.[39] The provisions in regard to dividends may, however, be such that a deficiency for one year, for want of net earnings of that year, is not to be made up from the net earnings of another year.[40]

The use of the word "guaranteed," in connection with preferred

[36] Corry v. Londonderry &c. R. Co. 29 Beav. 263; 7 Jur. N. S. 508; 30 L. J. Ch. 290.

[37] Henry v. Great Northern R. Co. 1 De G. & J. 606, per Lord Cranworth, Lord Chancellor; 4 K. & J. 1.

[38] Taft v. Hartford &c. R. Co. 8 R. I. 310; 5 Am. R. 575; Chaffee v. Rutland R. Co. 55 Vt. 110; McGregor v. Home Ins. Co. 33 N. J. Eq. 181; Lockhart v. Van Alstyne, 31 Mich. 76; 18 Am. R. 156; Lehigh Coal &c. Co. v. Central R. Co. 34 N. J. Eq. 88; Crawford v. North Eastern R. Co. 3 Jurist N. S. 1093; 3 Kay & J. 723; London India Rubber Co. in re, 37 L. J. Ch. 235; Matthews v. Great Northern R. Co. 5 Jur. N. S. 284; Stevens v. South Devon R. Co. 13 Beav. 48; 9 Hare, 313; Smith v. Cork &c. R. Co. Ir. R. 3 Eq. 356; affirmed, Ir. R. 5 Eq. 65. In this case the prior cases are reviewed at length.

[39] Matthews v. Great Northern R. Co. 5 Jur. N. S. 284; Smith v. Cork &c. R. Co. Ir. R. 3 Eq. 356; affirmed, Ir. R. 5 Eq. 65.

[40] Belfast &c. R. Co. v. Belfast, 77 Me. 445; 1 Atl. 362.

stock, does not change the legal effect of the rights of the holder of such stock.[41]

§ 626. **Preferred stockholders are not creditors.**[42] Stockholders are not entitled to any dividends as against the claims of general creditors. The capital stock of the company, as well as its property, is pledged for the payment of its debts.[43] But if certificates of scrip dividends have been issued in settlement of dividends on such preferred stock, convertible into the company's bonds on demand or at the option of the holder, and the company has converted most of such certificates, and has so acted that it is estopped to deny their validity, and it then refuses to convert the certificates of one holder into bonds, such holder is entitled to sue the company in assumpsit to recover the amount of the certificates; and it is no defense for the company that, at the time the scrip dividends were declared and the certificates issued, the net earnings were insufficient to pay them, together with the current expenses and floating debt of the company. The company itself cannot set up its own wrong in declaring the dividends, or its want of authority to exchange the certificates for bonds, so long as it does not appear that the company's refusal to exchange the certificates or to pay them was necessary to protect itself from embarrassment or its creditors from loss.

§ 627. **Where a mortgage is given to secure so-called preferred stock,** with power upon default in paying the stipulated dividends to foreclose and sell, and after paying all prior charges and liens to pay the preferred stockholders the par value of their stock from the proceeds of sale, the corporation is bound to pay the so-called dividends prior to its unsecured debts, or to subsequent mortgage debts. The preferred stockholders become, in fact, owners of a perpetual annuity secured by mortgage upon the property and income of the corporation, with a right to receive, from the proceeds of a foreclosure sale, payment of an agreed capitalized value of such annuity called the par value of the stock.[44]

[41] Taft v. Hartford &c. R. Co. 8 R. I. 310; Chaffee v. Rutland R. Co. 55 Vt. 110.

[42] See § 625 and cases cited.

[43] Chaffee v. Ruland R. Co. 55 Vt. 110.

[44] Miller v. Rattermann (Sup. Ct. of Cincinnati), 22 W. Law Bull. 99.

§ 628. **In ascertaining the profits of a railroad company for the purpose of making dividends on preferred shares,** the Master of the Rolls, Romilly, laid down the following rules:[45] "I am of opinion that all the debts of the company are first payable, other than those which, for want of a better expression, may be called funded debts; for instance, if the defendants have raised money by mortgage, under the powers contained in their act, for the purpose of completing their line, this does not constitute such a debt as can be paid off out of the profits before the profits are divided. But, on the other hand, any debts which have been incurred, and which are due from the directors of the company, either for steam engines, for rails, for completing stations, or the like, which ought to have been, and would have been paid, at the time, had the defendants possessed the necessary funds for that purpose, those are so many deductions from the profits, which, in my opinion, are not ascertained till the whole of them are paid."

In some cases it may be necessary to make provision for funded debts before applying net earnings to dividends. In determining what are net earnings, it may be essential to deduct not only the floating and temporary liabilities which good judgment would require to be presently paid, but also an annual contribution to a sinking fund for the payment of a mortgage.[46]

§ 629. **Such a question arose in relation to the preferred stock issued by the Erie Railway Company** between the years 1861 and 1869, in pursuance of a contract of reorganization entered into in 1859 between the shareholders and creditors of a prior corporation, known as the New York and Erie Railroad Company.[47] That com-

[45] Corry v. Londonderry &c. R. Co. 29 Beav. 263, 272. See New York &c. R. Co. v. Nickals, 119 U. S. 296; 7 Sup. Ct. 209, reversing 21 Blatchf. (U. S.) 177; Warren v. King, 108 U. S. 389; 2 Sup. Ct. 789.

[46] Belfast &c. R. Co. v. Belfast, 77 Me. 445; 1 Atl. 360.

[47] St. John v. Erie R. Co. 10 Blatchf. (U. S.) 271, 278; affirmed, 22 Wall. (U. S.) 136.

The terms "preferred stock" and "preferred dividends," taken by themselves and in connection with other words, are commented upon at length by Judge Blatchford, in giving the opinion of the Circuit Court in the foregoing case: . . . "The former holders of the unsecured bonds of the old company, by taking the preferred stock in exchange for their bonds, abandoned their position as creditors.

pany had failed to pay some of the interest due upon bonds issued by it and secured by mortgages, and certain of its unsecured debts. Foreclosure proceedings had been commenced, and a receiver of the property, covered by at least two of the five mortgages of the road, had been appointed. The shareholders, and bondholders under all of the mortgages, and the unsecured creditors, then entered into a contract whereby the mortgaged property was to be purchased for the account of the parties to the contract at the foreclosure sale. The

and became merely stockholders in the new company, as against then existing and all future creditors of the new company. They acquired the same right to vote as the holders of common stock. In the absence of any expressed intention to the contrary, it would be very unreasonable to suppose that the general power of the defendants to take leases of roads and to pay the rents on them, and to borrow money and issue bonds therefor and pay the interest on such bonds, would have been subordinated by the legislature or by themselves to the rights of any class of their stockholders, and equally unreasonable to suppose that the claims of creditors would have been postponed to those of stockholders. . . . . Moreover, the views urged on the part of the plaintiff, if sound, must be carried to their legitimate conclusions. The money has been borrowed on the sterling bonds. Their holders are creditors. If the company should become bankrupt, are the claims of those creditors to be repaid their principal to be postponed to the claims of the preferred stockholders, in respect to the capital of their shares? The stock is, in the contract, declared to be 'preferred stock,' as well as to be entitled to 'preferred dividends.' The statute and the certificates call it 'preferred capital stock.' If 'preferred stock,' why should it not have preference over the principal of subsequently created debts, if dividends on it are to precede the payment of interest on such debts? Yet such a claim would probably never be advanced, and certainly would not be admitted. The statement in the contract, the statute, and the certificates, that the 'preferred dividends' are to be paid out of the 'net earnings' sheds no light, one way or the other, for a solution of the question. The mortgage interest and the delayed coupons are also to be paid out of the net earnings. Net earnings are properly the gross receipts, less the expenses of operating the road to earn such receipts. Interest on debts is paid out of what thus remains, that is, out of the net earnings. Many other liabilities are to be paid out of the 'net earnings. When all liabilities are paid, either out of the gross receipts, or out of the net earnings, the remainder is the profit of the shareholders, to go towards dividends, which in that way are paid out of the net earnings."

holders of the mortgages were to be mortgagees under the new company, and the holders of unsecured bonds of the old company were to exchange their bonds for preferred stock equal in amount. The contract provided that the "preferred stock should be entitled to preferred dividends out of the net earnings, if earned in the current year, but not otherwise, not to exceed seven per cent. in any one year, payable semi-annually, after payment of mortgage interest and delayed coupons in full." The new corporation was formed under legislative authority, and preferred stock to the amount of $8,500,000 and upwards was issued. Dividends were regularly paid on this stock until the year 1868. In 1865, after the preferred stock was created, the company issued one million pounds of sterling bonds, unsecured by mortgage, bearing interest at six per cent. per annum in gold coin. They were issued for money borrowed to equip and repair the road, and the money was expended for these purposes. During the year 1868 the company paid the interest in full on these bonds; but on the 31st of December, 1868, after deducting the operating expenses, the interest paid on the mortgages existing January 1, 1862, and the rent of roads leased prior to that date, the net earnings were sufficient to pay only a partial dividend on the preferred stock; and of course, if no interest had been paid by the company on the sterling bonds, and no rent for roads leased after January 1, 1862, such dividend on the preferred stock would have been increased. A holder of preferred stock brought a bill in the Circuit Court of the United States praying that the court would ascertain and adjudge the meaning of the words "net earnings," and would enjoin the company from applying any portion of the net earnings, after payment of the interest on the mortgage bonds, to any other purpose than the payment of a dividend on the preferred stock. It was claimed in his behalf that, as the unsecured bondholders stood, when the contract was made, next in order as creditors to the holders of the mortgage bonds, they became entitled to occupy the same relative position as holders of preferred stock, and to receive their dividends on such stock out of the earnings, before the payment of interest on obligations incurred after the issuing of such stock; that the words, "after payment of mortgage interest and delayed coupons in full," did not mean merely "before any dividend is paid on the common capital stock," but meant "next after payment of mortgage

interest and delayed coupons in full;" that this construction is sensible, because of the prior position of the preferred stockholders, as holders of unsecured bonds entitled to be paid interest next after the payment of mortgage interest; that they did not waive, but preserved, their position as entitled to such interest, and only modified their right in regard to the repayment of the principal of their debts; that the preferred stock is only a new form of security for the debts in exchange for which it was issued, holding the same place, and entitled to be paid the same interest, as such debts were entitled to when the exchange was made subject to the proviso as to the earning of the interest in the current year; that the holders of the preferred stock are not subject to the contingencies of new loans and new leases, and extended enterprises; that while the contract contains no limitation on the power of the company to issue interest-bearing securities, it contains a limitation on their power of disposing of their net earnings; that the shares of preferred stock are, in fact, perpetual bonds, with no right to the repayment of the principal, but with a specified preferential right in regard to interest; that the fact that it is called "stock," and that it is declared to be entitled to "dividends," and that its holders have an equal right to vote with the holders of common stock, cannot destroy the rights which appertain to it by the terms of the contract. But it was held that the preferred stockholders were not entitled to a dividend before the payment of interest on such bonds.

§ 630. **Preferred dividends payable out of net earnings are not in the nature of interest** constituting a debt, but are payable only out of profits in the manner specified by the contract. The decree of the Circuit Court, in the case last under consideration, was upon appeal affirmed by the Supreme Court of the United States.[48] Mr. Justice Swayne, delivering the opinion of the court, considered the effect of the agreement for reorganization as regards the preferred stockholders. "The original takers of the preferred stock were creditors. They abandoned that position and became stockholders. They thereupon ceased to be the former, and can only be regarded as the

[48] St. John v. Erie R. Co. 22 Wall. (U. S.) 136. See, on point that such dividends are not a debt due absolutely, Taft v. Hartford &c. R. Co. 8 R. I. 310.

latter. They surrendered their debts and received in return stock of the same amount, which gave them a chance for annual dividends of seven per cent., and a voice by voting in the choice of those by whom the affairs of the company were to be administered. What they were to receive was not interest, but dividends; and they were to receive them in priority to the holders of the common stock. The latter could receive nothing until the former were satisfied. The maximum payment on the preferred stock was specified. It might be less, or nothing. It could not be more. The amount subject to the limit prescribed depended wholly upon the residue of the net earnings applicable in that way. The language employed is apt to express the relation of stockholders. None to express the relation of creditors is found in the instrument; and there is nothing from which the intent to continue that relation any longer can be inferred. If the mortgages were foreclosed, and there were a surplus left insufficient to satisfy the general creditors, it is quite clear that the holders of the preferred stock could have no right to share in the fund." The claim made in behalf of the preferred stockholders, that the *net earnings* are predicated of things as they were when the preferred stock was issued, the learned judge declared to be without support, express or implied. The company had a right to take new leases and make new mortgages. It had the right so to conduct its operations, in good faith, as it might see fit; and it was from them and all of them that the materials for the computations of earnings were to be derived. In conclusion, it was the judgment of the court that the rents for the year, accruing under leases taken by the company after the issuing of the preferred stock, and the interest upon the sterling bonds for that year, were properly paid; and that there were no net earnings earned in that year which could be properly applied in payment of preferred dividends.

§ 631. **One who takes stock in a corporation takes it subject to the control of its directors,** and though it stipulates that a certain rate of interest shall be paid to preferred stockholders in preference to the payment of any dividend on the common stock, if the same be earned, the directors may, acting in good faith, apply the net earnings to the improvement of the company's property, instead of paying a dividend to the holders of the preferred stock. In other

words, the preferred stockholders are not entitled as of right to dividends payable out of the net profits accruing in any particular year, unless the directors declare or ought to declare a dividend payable out of such profits. Whether a dividend should be declared in any year, is a matter belonging in the first instance to the directors to determine, with reference to the condition of the company's property and affairs as a whole.[49]

§ 632. The net earnings of a corporation are the excess of the gross earnings over the expenditures incurred in producing them, aside from, and exclusive of, the expenditure of capital laid out in constructing and equipping the works themselves. The expenses chargeable to earnings include the general expenses of keeping up the organization, and of operating the works and of making ordinary repairs and improvements. Expenditures for construction include not only expenses incurred in the original construction of the works, but those subsequently incurred in the enlargement and substantial improvement of such works.[50]

§ 633. A definition of net earnings or of expenses contained in the charter of a company and in an agreement for reorganization is binding upon the directors of the company. Thus a railroad company was reorganized and reincorporated on the basis of an agreement entered into by the secured creditors and the stockholders, one provision of which was that the holders of common stock were not to be entitled to shares, or to vote, until the preferred stockhold-

[49] New York &c. R. Co. v. Nickals, 119 U. S. 296; 7 Sup. Ct. 209; Warren v. King, 108 U. S. 389; 2 Sup. Ct. 789. See, also, Barnard v. Vermont &c. R. Co. 7 Allen (Mass.) 512; Williston v. Michigan &c. R. Co. 13 Allen (Mass.) 400; Chaffee v. Rutland R. Co. 55 Vt. 110; Elkins v. Camden &c. R. Co. 36 N. J. Eq. 233; Lockhart v. Van Alstyne, 31 Mich. 76; 18 Am. R. 156; Culver v. Reno Real Estate Co. 91 Pa. St. 367.

There is nothing inconsistent with the doctrine above stated in the cases of Dent v. London Tramways Co. L. R. 16 Ch. Div. 344; Richardson v. Vermont &c. R. Co. 44 Vt. 613; Boardman v. Lake Shore &c. R. Co. 84 N. Y. 157.

[50] Union P. R. Co. v. United States, 99 U. S. 402, 420, per Bradley, J.; United States v. Kansas &c. R. Co. 99 U. S. 455; United States v. Sioux City &c. R. Co. 99 U. S. 491; United States v. Central R. Co. 99 U. S. 449.

ers had been paid seven successive annual dividends of seven per cent.; and the new charter provided that the funds applicable to the payment of dividends on preferred stock was the net income, "after paying interest on prior bonds, repairs, expenses of equipment," etc., any surplus, after paying seven per cent., to stand over until the next dividend day. At the first meeting of the board of directors it was resolved that "under operating expenses only such improvements and additions should be included as were necessary to keep the property efficient, and that all beyond this should be provided for out of funds other than net earnings." It was held that the provisions of the agreement and of the charter, as interpreted by the resolution, were binding upon the directors; and it having been made to appear that the earnings and income, which had been wrongfully converted to pay for improvements and extensions, would, if applied to dividends, be sufficient to pay five successive dividends of seven per cent. each on the preferred stock, that the common stock was entitled to representation.[51]

[51] **Mackintosh v. Flint &c. R. Co.** 34 Fed. 582.

CHAPTER XX.

FORECLOSURE SALES UNDER CORPORATE MORTGAGES.

I. Sale of entire property, §§ 634–638.
II. Conduct of sale, §§ 639, 640.
III. What franchises pass by the sale, §§ 641–644.
IV. Distribution of proceeds of sale, §§ 645–650.
V. Setting aside of sale, §§ 651–669.

I. *Sale of Entire Property.*

§ 634. **There is no principle of common-law which deprives the owners of property of the right to confer upon a trustee the power to sell** mortgaged premises upon default, and there is no difference in principle between a power of sale in the mortgage itself and one in a separate power of attorney. In a case arising in the Federal Court for the Northern District of Ohio, the Circuit Court of Appeals, held, in reviewing the judgment below, that the Ohio statutes regarding appraisement in force in 1904 did not forbid the exercise of a power of sale conferred by a trust deed, without any appraisement of the property.[1]

§ 634a. **Under a deed of trust which contemplates but one sale, the entire property may be sold** upon a default in the payment of interest. It is, moreover, a well-settled rule that the whole property may be sold upon a default in the payment of interest before the principal is due, when the property cannot be sold in parts without

[1] Etna &c. Co. v. Marting &c. Co. 127 Fed. 32.

injury to the whole.[2] As a general rule, it is evident that a continuous line of railroad cannot be cut up and sold piecemeal without destroying its value. The unity and continuity of a line of railroad are among the important elements of its value. Therefore, although a mortgage contains no provision making the whole debt due upon a default in the payment of interest, and no provision authorizing a sale of the whole property covered by the mortgage, a court of equity will upon such default order a foreclosure and sale of so much of the property as will satisfy the instalments then due;[3] and generally, if the property cannot be divided without injury, a sale of the whole would be decreed.

A portion of the mortgaged premises, if divisible, may be sold upon default in paying one instalment of the debt, and then upon a second default a further order of sale may be made.[4]

Cars, engines, and other property placed upon the road by the receiver to keep it in repair and working condition, pass to the purchaser. "The bondholders might as well claim that a bridge rebuilt by the receiver did not pass by the sale, as to claim that engines and cars put upon the road, and necessary to keep up its equipment and do its business, did not pass Money so expended is no more income and profit than money paid to engineers and brakemen for their services."[5]

But the purchaser is not entitled to money in the hands of the receiver which represents the surplus earnings of the railroad. The mortgagees are entitled to such surplus.[6]

When, under a deed of trust of a railroad and all its property, the trustees without the aid of a court, by following the terms of

[2] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.) 447. See 2 Jones Mortgages, §§ 1181, 1459, 1478, 1616–1619; Credit Co. v. Arkansas &c. R. Co. 15 Fed. 46, 52; Chicago &c. R. Co. v. Fosdick, 106 U. S. 47; 1 Sup. Ct. 10; Farmers' &c. Co. v. Oregon &c. R. Co. 24 Fed. 407.

[3] Goodman v. Cincinnati &c. R. Co. 2 Dis. (Ohio) 176; West Branch Bank v. Chester, 11 Pa. St. 282; 31 Am. Dec. 547.

[4] Fleming v. Soutter, 6 Wall. (U. S.) 747; Tillinghast v. Troy &c. R. Co. 48 Hun (N. Y.) 420, 425; 1 N. Y. S. 243, per Learned, P. J.

[5] Strang v. Montgomery &c. R. Co. 3 Woods (U. S.) 613, 619, per Woods, J.

[6] Strang v. Montgomery &c. R. Co. 3 Woods (U. S.) 613, 619, per Woods, J.

the deed, might sell the entire line of road upon a default in the payment of interest before the maturity of the principal, the power of the trustees is not any the less when the court has been asked by the bondholders to construe the deed of trust and to order the trustees to execute it. If the trustees in such case sell the whole road as an entire and indivisible property, under the direction of the court, they do so by virtue of the power vested in them by the deed. The court does not foreclose the mortgage as in an equitable foreclosure. It does not confer upon the trustees any power which they did not already possess, by virtue of the deed of trust, or impose upon them any new duties, but simply tells them what their powers are under the deed, and requires them to exercise these powers for the benefit of the *cestui que trust*.[7]

[7] Wilmer v. Atlanta & R. A. L. R. Co. 2 Woods (U. S.) 447, 456. In a few states special provision has been made by statute in regard to the sale of the entire property. Thus, in Indiana, 1 R. S. 1876, p. 728, ch. 218, § 1, Act March 3, 1865, it is provided that in case of the sale of any railroad and its property, under or by the authority of any competent court, part of which railroad may be situate within the state and part in an adjoining state, and embraced in the mortgage or deed of trust, the whole may be sold at one time and place, as an entirety, at such point on the line of said railroad, either within or without the state, and upon such notice, as the court or courts ordering such sale may direct.

See statute in New Jersey, R. S. 1877, p. 922, § 77.

In Kansas, Laws 1876, ch. 108, § 1; Dassler's Stats. 1876, § 4625, it is provided that in actions to enforce a mortgage or deed of trust, executed by any railroad company upon its railroad or other property, or any portion thereof, if the property mortgaged shall be situated in more than one county in this state, the District Court of any one of such counties shall have jurisdiction to render judgment against such company for the amount found due, in the same manner as is provided by law concerning other debts secured by mortgage on real property, and to decree and enter an order for the sale of said mortgaged property, and to provide for the terms and method of payment of the purchase price of the property ordered to be sold; which order shall be directed to the sheriff of any or either of the counties in which said mortgaged property is situated.

In Kentucky (Laws 1876, ch. 447, § 1), it is provided that sales of the property and franchises of railroad and turnpike corporations, when adjudged by a court, shall be after such notice and advertisement, and at such place as, in the discretion of the court, shall seem proper; and if such sales are made on the

In some cases a court of equity will, before the maturity of its bonds, order the sale of a railroad under a mortgage which does not in terms authorize a sale upon a default in the payment of interest. This was done in a case where it appeared that the mortgagor was insolvent; that an execution purchaser under a junior incumbrance would do nothing to discharge the interest; that the operation of the road by the mortgage trustee would be at a loss; that the trustee had no funds with which to make repairs; and that the road, if unused, would necessarily decay.[8]

§ 634b. **Notwithstanding a constitutional provision requiring rolling stock to be treated as personal property,** it is still within the discretion of a court to order railroad property covered by a deed of trust to be sold in bulk, as an entirety, where the deed by its terms seems to contemplate but one sale. The wishes of the debtor in this respect may be followed with safety to the creditor and without injury to others having claims against the company or its property.[9]

§ 635. **Sale of consolidated road.**—Upon the foreclosure of a mortgage upon a road constituted by the consolidation of several roads, each of which was subject to a mortgage before the consolidation, the court may properly direct the sale of the consolidated road

foreclosure of one or more mortgages or deeds of trust, the court may order such sale to be made for the whole amount of the outstanding bonds and interest secured by such deed or deeds of trust or mortgage; or, if said property and franchises will produce so much, then for the amount of interest due under said deed or deeds of trust or mortgage, or either of them, subject to the payment by the purchaser of the outstanding bonds, and interest secured thereby, as they become due; and in the latter event may, by proper orders, secure the assumption thereof by the purchaser.

In New York the Supreme Court may direct a sale of the whole of the property, rights, and franchises covered by the mortgage or deed of trust, at any one time and place to be named in the judgment or order, either in the case of the non-payment of interest only, or of both the principal and interest due and unpaid and secured by such mortgage or deed of trust. Laws 1876, ch. 446, p. 482.

[8] McLane v. Placerville &c. R. Co. 66 Cal. 606; 6 Pac. 748.

[9] Southwestern &c. R. Co. v. Hays, 63 Ark. 355; 38 S. W. 665, citing text.

as a whole, instead of a sale in divisions corresponding to the original roads; and after the sale the court may fix the amount to be paid to the several holders of the bonds of the respective roads; for the reason that the road would naturally sell for a better price if sold as a whole than if sold in divisions.[10]

In like manner where a single mortgage, given to secure three series of bonds, each of which constituted a first lien upon one of three divisions of the road and a second lien upon the other two, was foreclosed, the three divisions were not sold separately. Nor was it necessary that the property be offered both in separate divisions and as an entirety and the most advantageous bid accepted, but the entire property should be sold as an entirety, and the proceeds apportioned among the bondholders of the three classes according to the relative value of three divisions as found from the evidence.[11]

§ 636. Sale of road built by new company.—Upon the foreclosure of a mortgage made by a railroad company upon its entire road, the building of which was abandoned after the completion of a middle section of it, and was subsequently completed by another company, it is erroneous to decree a sale of the completed or middle portion only, leaving the two ends worthless. If any foreclosure can be had, the entire road should be sold, and the proceeds distributed as between the mortgagee and the new company in the proportion which the work done by the first company bears to the value of the entire completed road.[12]

But if the original company had no legal title to any part of the right of way, but only contracts for conveyances which the company never became entitled to by performing the conditions which would entitle it to conveyances, and a new company is organized and completes the road, and acquires the legal title to the right of way, no decree of foreclosure can be sustained under a mortgage given by the original company, as against the new company, for a sale of the road.[13]

[10] Gibert v. Washington City &c. R. Co. 33 Gratt. (Va.) 586; and see Farmers' &c. Co. v. Newman, 127 U. S. 649; 8 Sup. Ct. 1364.

[11] Low v. Blackford, 87 Fed. 392; Farmers' &c. Co. v. Cape Fear &c. R. Co. 82 Fed. 344.

[12] Chicago &c. R. Co. v. Loewenthal, 93 Ill. 433.

[13] Chicago &c. R. Co. v. Loewenthal, 93 Ill. 433.

§ 637. When specific property subject to a separate incumbrance can be sold separately without injury to other property, as for instance when a section of a railroad subject to a separate mortgage can be sold by itself, without sacrificing the whole line of road, it should be thus sold in order that the incumbrancer may have a chance of protecting his securities without involving himself in onerous engagements. Cases sometimes occur where a sale of the entire property covered by different mortgages must be made absolutely, and the different claims adjusted upon the fund subsequently; thus, when a sale of a portion of a railroad, which is subject to a separate mortgage, would be injuries to the entire property, which is subject to other mortgages under which a sale of the entire road is asked for, it may be that the only just course that can be pursued is to sell the whole and adjust the rights of the mortgagees afterwards.[14]

If the holders of a general mortgage upon a railroad sell the property as an entirety, when a portion of it is subject to a prior lien which the holder asks to have paid, they will be deemed to have elected not to sell the property in parts, or subject to the prior lien; and consequently the prior lien-holder is not restricted to a lien upon that portion of the railroad embraced in his mortgage, but he is entitled to be first paid out of the aggregate proceeds of the sale of the entire property.[15]

If a prior lien cover an important part of a road, and its control by the receiver is essential to keeping the road a going concern, the court may well conclude that the whole property is interested in preserving it, and so a general fund can be used in extinguishing the lien. The sale of the part of the road covered by the lien would be resorted to only in the last extremity. But, if reduced to this necessity, the court could order a sale.[16]

§ 638. Upon the foreclosure of a mortgage of a railroad and its franchise for a failure to pay an instalment of interest, when the mortgage contains no provision that the principal shall become due upon such default, if the property can be divided without in-

[14] Campbell v. Texas &c. R. Co. 2 Woods (U. S.) 263.

[15] Farmers' &c. Co. v. Newman, 127 U. S. 649; 8 Sup. Ct. 1364.

[16] Wheeling &c. R. Co. v. Reyman Brewing Co. 90 Fed. 189.

jury, only so much of it should be sold as will satisfy the amount due, but if it is not susceptible of division, as would usually be the case, it must be sold as an entirety. When, however, it seems probable that the property is worth much more than the amount of the debt and interest, the court may very properly upon the request of the company, order the property to be leased for the shortest term that will produce the amount due, and the accruing interest. The court should, in such case, require the lessee to give a covenant with approved security to keep the property in good repair, and to return it at the end of the term in as good condition as it may be when received.[17]

After a sale of an entire road has been made upon a default in the payment of interest due upon a mortgage of it before the principal debt is due, the proceeds are applied in the first place to the payment of the interest for the satisfaction of which the sale was made, and the remainder is brought into court, to be disposed of under its direction.[18]

II. *Conduct of Sale.*

§ 639. The marshal or other officer, who makes a sale under a decree of foreclosure, is not only invested with a reasonable discretion as to the manner of conducting the sale, but is not at liberty to overlook or disregard such discretion. Acting under the decree, he has duties to perform to the complainant, to the vendor and purchaser, and to the court, and is bound to exercise his best judgment in the performance of all these duties. The usual practice is for the officer in selling the property to act under the advice of the solicitor of the complainant. "Granting that solicitors may properly advise the officer, still it must be borne in mind that the authority and discretion in making the sale are to a certain extent primarily vested in the officer designated in the decree. Unreasonable directions of the solicitor are not obligatory and should not be followed; as if the solictor should direct the property to be struck off at a great sacrifice when but a single bidder attended the sale. Under such circum-

[17] Bardstown &c. R. Co. v. Metcalfe, 61 Ky. 199; 81 Am. Dec. 541.

[18] Wilmer v. Atlanta &c. R. Co. 2 Woods (U. S.) 447.

stances the officer might well refuse to do as he was directed, and he might be justified in postponing the sale to a future day to prevent the sacrifice of the property. Every such officer has a right to exercise a reasonable discretion to adjourn such a sale, and all that can be required of him is, that he should have proper qualifications, use due diligence in ascertaining the circumstances, and act in good faith, and with an honest intention to perform his duty."[19]

In a case of a sale of a railroad under a decree of foreclosure which directed the marshal to sell at public auction, unless the mortgagors, previously to such sale, should pay to the complainants the sum of $254,175, being the amount of the decree, four different adjournments, extending over a term of seven months, were made for the purpose of enabling the mortgagors to make an arrangement to pay the debt; and although a bid of nearly the whole amount of the debt was made on the second day fixed for the sale, and the whole amount of the debt was bid on the third day fixed for the sale, and the adjournments were made by direction of the complainant's solicitor, the company having redeemed before the fourth day to which the sale was adjourned, it was held that the adjournments were made for sufficient cause, and the sale was properly discontinued. The highest bidder has in such case no right to insist upon being allowed to pay the amount of his bid, and have a confirmation of the sale to himself.[20]

It is a proper practice in the sale of large railroad properties to require each bidder to make a deposit of a substantial sum of money, —say fifty thousand dollars.[21]

§ 640. A mortgage trustee will be left to exercise his discretion as to the time of making the sale under a decree of foreclosure, and as to making a sale at all pending an appeal from the decree, which the appeal does not supersede. The trustee is the representative of all the bondholders, and it is for him to determine whether the best interests of all concerned would be promoted by a sale, and individual bondholders have no right to insist upon an execution of the decree.

[19] Blossom v. Railroad Co. 3 Wall. (U. S.) 196, 208, per Clifford, J. See 2 Jones Mortgages, §§ 1633–1635.

[20] Blossom v. Railroad Co. 3 Wall. (U. S.) 196.

[21] Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 380.

The Central Railroad Company of Iowa having made default in payment of interest, some of the bondholders requested the trustee to foreclose the mortgage. He did not, however, institute proceedings to foreclose, and thereupon these bondholders brought suit for this purpose in the Circuit Court of the United States for the District of Iowa, and made the trustee a party to it. A demurrer, on the ground that the trustee only could bring such suit, was overruled. The trustee then asked and obtained permission to file a bill to foreclose, and upon filing such bill the action was consolidated with that commenced by the bondholders. A decree of sale was entered at the October Term, 1875, upon the assumption that the parties to be affected assented to the decree. This assumption was not, however, well founded, for certain other bondholders, having been allowed to intervene, took an appeal to the Supreme Court of the United States. They perfected the appeal; but failing to give bond as required, the *supersedeas* was discharged. A committee of bondholders asked the trustee to order the special master to proceed with a sale of the road, and the trustee failing to do this, the committee directed the master to sell. This he refused to do. The trustee thereupon petitioned the court for advice in respect to the sale, and the committee of bondholders moved for an order directing the trustee and master to execute the decree. Dillon and Love, JJ., upon a hearing in March, 1877, declined to order a sale, the latter saying:[22] "I confess I do not see the way clear in the future, if the *status quo* of the trust property be changed, as required by the terms of the decree. On the contrary, it appears to me that no complications can possibly arise if the decree be not executed. Nor can I see clearly that any special injury will result to the parties in interest by reason of the delay. If the majority feel aggrieved by the refusal of the court to grant their present motion, I suppose they have their remedy! they can apply for a mandamus, and thus submit their case to the judgment of the Supreme Court, and if it be a matter of right in them, and not of discretion in the Circuit Court, they can thus obtain redress."

In accordance with this suggestion, the parties went before the Supreme Court on an application for a mandamus to compel the Circuit Court to execute the decree by a sale of the road, but the

[22] Farmers' &c. Co. v. Central R. Co. 11 West. Jurist, 428, 430; 5 Cent. L. J. 56; 4 Dill. (U. S.) 533.

application was refused on the ground that the trustee is the representative of all the bondholders, and that the latter have no legal right to insist upon an execution of the decree, and should not, in their individual capacity, be allowed to interfere with his discretion, except upon strong and clear reasons. If they are dissatisfied with the trustee, their remedy is to apply to have him removed, under a provision in that behalf contained in the trust deed, and get a trustee to carry out their wishes if they can.

Afterwards, at the May term of the Circuit Court, application to compel the trustee to sell the road under the decree was renewed, when Judge Dillon, with the concurrence of Judge Love, again refused it, saying, after reciting the action of the Supreme Court in this case, that, while the decision of that court is conclusive against the legal right of these parties to have this decree executed, at the same time there is no restraint in the decree, or in what has been decided in either court against its execution; that the appeal did not supersede it, and that the trustee is at perfect liberty, whenever he sees fit, to execute the decree; that as far as the court is concerned, considering the trouble this road had given it by reason of the controversies and factions among the bondholders, it would be glad if the trustee could see his way clear to execute the decree, and get the road out of court, and into the hands of parties who could control it satisfactorily; that it should be understood that the trustee incurs no personal liability by executing the decree; and that the only question for the trustee to determine is whether the best interests of all the *cestuis que trustent*, or bondholders, would be best promoted by now executing the decree, or by allowing it to stand until the determination of the appeal.[23]

[23] In Kansas the time and manner of making sales of railroads, in all cases of foreclosure of mortgages or deeds of trust, are provided for by statute. Laws of 1876, ch. 111; Dassler's Stats. 1876, §§ 4627, 4631. See Laws of 1877, ch. 108, for act regulating procedure when the mortgaged property is situate in more than one county. For construction of statute see Samuel v. Holladay, Woolw. (U. S.) 400.

The provision, that a sale under a railroad mortgage containing a waiver of appraisement cannot be made by the court until the expiration of six months after the decree of foreclosure, is binding upon the federal courts. Benedict v. St. Joseph &c. R. Co. 19 Fed. 173.

§ 640a. The fact that a sale advertised for ten o'clock did not occur until some hours later does not invalidate it, it appearing that the sale was cried substantially at the hour set and that no objection to proceeding with the sale was then made by representatives of the complainant present at the time. The delay was caused by an effort to enjoin the sale on the ground that it was unauthorized without an appraisement of the property.[24]

III. *What Franchises pass by the Sale.*

§ 641. The franchise of a corporation.—The sale of the property and franchises of a railroad corporation, under a decree to satisfy a mortgage, does not pass to the purchaser debts due the corporation, nor does it destroy its corporate existence. For the purpose of collecting and paying debts the corporation still exists.[25]

The sale by one railroad company to another of a portion or division of an existing line of road with its franchises is construed to mean only the franchise of operating that part of the road, and not the franchise of being a corporation, and of suing and being sued as such. Both companies, after such sale, retain precisely the same corporate existence they had before, the one parting with and the other acquiring a specific piece of property with the franchise necessary to its use.[26]

The right granted a railway company to occupy a street is not such a mere personal license as to be incapable of transfer or mortgage, and passes to the purchaser on foreclosure sale under mortgage of its property rights, privileges, and franchises.[27] This is in accord with the general rule that rights acquired by a company in relation to its right of way under its charter pass to a purchaser at a foreclosure sale.[28]

[24] Etna &c. Co. v. Marting &c. Co. 127 Fed. 32.

[25] Smith v. Gower, 3 Metc. (Ky.) 171; Higgins v. Downward, 8 Houst. (Del.) 227; 40 Am. St. 141. See §§ 15, 16.

[26] Wright v. Milwaukee &c. R. Co. 25 Wis. 46; James v. Western R. Co. 121 N. C. 523; 28 S. E. 537; 46 L. R. A. 306.

[27] Denison &c. R. Co. v. St. Louis &c. R. Co. 96 Tex. 233; 72 S. W. 161, 201.

[28] Barker v. Southern R. Co. 137 N. Car. 214; 49 S. E. 115.

Under a statute which provides that a corporation shall be dissolved by a mortgage sale of its franchises and property, an illegal and fraudulent sale does not work a dissolution.[29]

§ 641a. A judgment obtained by a railroad company and not covered by a mortgage on its property does not pass on a foreclosure sale to purchasers who are by virtue of legislative act organized into a new corporation. The legislature had no power under the constitution to take away privileges and immunities from the old corporation and give them to the new one. A franchise is property, and it cannot be wantonly taken away by a legislative act.[30]

Although the beneficiaries in a trust deed may maintain an action for whatever injury they suffer by wrongful impairment of their securities, a purchaser at foreclosure sale becomes invested with no such right, since he acquires no interest whatever in the debt secured.[31]

§ 642. A mortgage by a railroad company does not pass any interest in land taken for its right of way which it has failed to pay for. Its interest in such land is a mere easement, and not an estate in the land subject to lien or execution. The land-owner's title to damages is paramount to a mortgage given by the railroad company before the damages have been assessed and paid. Although he allows the company to construct a road over his land, and to use it without payment of damages, and thus waives the trespass, he does not necessarily waive his claim for damages; and a prosecution of his claim to judgment is conclusive against such waiver. A sale of the road under a mortgage before the damages are paid does not divest the land-owner of his right to recover compensation for the occupancy of his land from the purchaser.[32]

But when a railroad company, being unable to agree with the owners of lands for a right of way, gives a bond with sureties and takes possession, a sale under a mortgage subsequently made gives

[29] White Mountains Railw. v. White Mountains Railw. 50 N. H. 50.

[30] Higgins v. Downward, 8 Houst. (Del.) 227; 32 Atl. 133; 40 Am. St. 141.

[31] McCaleb v. Goodwin, 114 Ala. 615; 21 So. 967.

[32] Western R. Co. v. Johnston, 59 Pa. St. 290; Pfeifer v. Sheboygan &c. R. Co. 18 Wis. 155; 86 Am. Dec., 751; Ingalls v. Byers, 94 Ind. 134.

the purchaser a clear title, and the land-owner is thrown back upon the bond for his damages.[33]

Of course, a right of way acquired by a railroad company by grant from the land-owner passes by a mortgage, and by a foreclosure sale under the mortgage, and vests in the purchaser.[34]

§ 643. **Interest on purchase money.**—When a purchaser at a judicial sale for the foreclosure of a mortgage is immediately put into possession of the property, he is chargeable with interest on the amount of the purchase money to the time of its payment.[35]

§ 644. **A purchaser at a foreclosure sale under a decree in chancery subjects himself to the jurisdiction of the court,** and can be compelled to perform his agreement specifically. He undoubtedly has the corresponding right to appear and claim at the hands of the court such relief as the rules of equity proceedings entitle him to. If the court refuses to order the sale either to be set aside or completed, he may carry the matter by appeal to the appellate tribunal. The act complained of is not a mere ministerial duty, necessarily growing out of the decree which is being carried into effect, but the purchaser has in the course of the subsequent proceedings in the case acquired rights which the court is bound to protect, and has become a *quasi* party to the proceedings.[36]

A decree confirming a foreclosure sale, if it is final, may be appealed from.[37] Upon such an appeal from the Circuit Court of the United States to the Supreme Court, the refusal of the former court to accept a *supersedeas* bond, when offered during the term at which the decree was rendered, does not take from a judge of that court, or a justice of the Supreme Court, the power to approve one thereafter.[38]

[33] Fries v. Southern R. &c. Co. 85 Pa. St. 73; distinguished from Western R. Co. v. Johnston, 59 Pa. St. 290.

[34] Junction R. Co. v. Ruggles, 7 Ohio St. 1; Barker v. Southern R. Co. 137 N. C. 214; 49 S. E. 115.

[35] Haven v. Grand Junction R. &c. Co. 109 Mass. 88; Columbus &c. R. Co. v. Braden, 110 Ind. 558; Ingalls v. Byers, 94 Ind. 134.

[36] Blossom v. Milwaukee &c. R. Co. 1 Wall. (U. S.) 655. See 2 Jones Mortgages, §§ **1642–1651.**

[37] Sage v. Railroad Co. 96 U. S. 712; Butterfield v. Usher, 91 U. S. 246; Blossom v. Milwaukee &c. R. Co. 1 Wall. (U. S.) 655.

[38] Sage v. Railroad Co. 96 U. S. 712.

IV. *Distribution of the Proceeds of Sale.*

§ 645. In the distribution of the proceeds of a foreclosure sale, liens at law have precedence of equities. Thus, land was sold to a railroad company under an agreement that the vendor should receive as part of the consideration bonds of the company secured by a second mortgage to be issued. He delivered the deed, but before the mortgage was issued the company confessed certain judgments. The vendor then refused to receive the bonds because of the judgments, and the bonds were thereupon otherwise appropriated by the company. Upon a distribution of the proceeds of a foreclosure sale, it was held that the vendor, having rejected the bonds, had no further claim upon them, and the company could dispose of them as it pleased; and that, the mortgage having been given to secure the bonds and the vendor not owning them, he had no lien, equitable or legal, through the mortgage for the purchase money for which the bonds were to be delivered to him.[39]

§ 646. Every bond is entitled to its pro rata share. In the distribution of the proceeds of a foreclosure sale under the mortgage securing a series of bonds, the holders of the bonds share pro rata in the distribution; and if the holder of a bond is entitled to its proceeds, the holders of other bonds cannot set up mere informalities in the manner of its acquisition. The question of ownership, whether at law or in equity, is immaterial. The time and manner of the transfer of the bonds are not material; the only real question is whether each holder is entitled to the bonds he claims. Each bond carries with it a fractional interest in the proceeds of the mortgaged property, determined by the proportion the amount of the bond bears to the whole amount secured.[40]

The true rule, furthermore, is that the security inures to the benefit of each bondholder in the proportion which his bonds bear to the entire amount actually issued and intended to be issued. It would be a strange doctrine to hold that each separate bondholder is only secured by the mortgage to the extent of his aliquot portion of the property covered, to be determined by the proportion his bondhold-

[39] Rice's Appeal, 79 Pa. St. 168. [40] Hodge's Appeal, 84 Pa. St. 359.

ings bear to the whole amount contemplated to be issued, but which were not in point of fact issued.[41]

§ 647. **In distributing the proceeds of a foreclosure sale, the payment of coupons which matured before a general default may be preferred** by the court when there is nothing in the mortgage requiring a pro rata distribution. Thus, unpaid coupons or interest belonging to a class in which a part of the coupons or of the interest has been paid should be paid before coupons or interest falling due at a later date, and before the principal of any of the bonds; and coupons detached, and in the hands of others than the holders of the bonds from which they were detached, should be paid before such bonds.[42] On July first, 1873, a company made default in the entire amount of interest then falling due, amounting to $280,000, and never made any payment afterwards. The unpaid interest previously due amounted to about $30,500, which had matured at different times for several years previous. Against this preference it was contended that there was no principle, legal or equitable, upon which it could be made; that it was not shown that payment of the interest was ever demanded and refused; that no right to be paid the interest accrued until demand and refusal, and until then there was no default; that the company was justified in paying subsequently maturing interest, even though prior maturing interest remained unpaid, so long as the payment of such prior maturing interest had not been demanded; that he is prior in right who is prior in the time of presenting his demands, when presentment is required; and that those who, prior to July first, 1873, received their interest, received no preference as against those who did not receive their interest, because the latter did not demand it and the former did. The general principle was invoked that, where general debts are secured by one and the same mortgage, and become due, and the mortgage is then foreclosed, they will be paid pro rata from the fund, if it is insufficient to pay the whole of them; and that the only exception to this rule is where the mortgage, by its terms, creates a preference in favor of some of the debts, or where the original creditor, as to any which he has as-

[41] Coal Co. v. Land Co. 106 Tenn. 41; 60 S. W. 502.

[42] Stevens v. New York &c. R. Co. 13 Blatchf. (U. S.) 412; and see Virginia v. Chesapeake &c. Co. 32 Md. 501. See §§ 247–252.

signed, has designed to confer a right of prior satisfaction on the assignee.

In support of the preference it was contended that as to the interest which matured prior to July first, 1873, inasmuch as some of the parties entitled to it had received it and some had not, the former will have received a preference, unless the latter are now to be put on an equal footing. To this it was replied that there really was no preference; that, so long as the debtor was solvent, every party entitled to interest was paid as he presented his matured claim; that, if he did not present it, he took the risk of the debtor's becoming insolvent; and that he had no special property in, or lien on, the funds of the debtor, which could require the debtor to set apart funds sufficient to pay undemanded matured interest which fell due at an earlier date, before paying demanded matured interest falling due at a later date. The court held that the unpaid coupons were entitled to be preferred in the distribution.[43]

[43] Stevens v. New York &c. R. Co. 13 Blatchf. (U. S.) 412, 416. Judge Blatchford, delivering the opinion of the court, said: "I do not think any distinction can be made between interest which matured before July 1st, 1873, and interest which matured on that day, growing out of the fact that payment of the latter was demanded and refused, or a demand was waived, and that the former was not demanded. I do not see how any diligence of those of a given class who were paid their interest, in asking to have it paid, can be imputed as laches to others of the same class who did not ask to be paid their interest, so as to work a virtual preference in favor of the former. To give to the latter their interest in full, before paying the principal of the bonds, is only to put all those in a given class entitled to interest on an equal footing; and to put them on such equal footing requires, also, that interest maturing at an earlier date shall be paid before interest maturing at a later date. Here are special equities, it seems to me, which would be violated, if such an inequality were left to exist as the exclusion from the full payment of interest of some of a given class. There is nothing in the terms of the mortgage, in this case, which requires such exclusion. On the contrary, the mortgage provides that, after default, the mortgagees shall sell so much of the mortgaged property 'as shall be necessary to pay and discharge the principal and interest, according to the tenor thereof,' of all the bonds issued, and shall, out of the moneys arising from such sale, pay the principal and interest which shall then remain due and unpaid on the issued bonds. The words, 'according to the tenor

The coupons which fell due July first, 1873, were not paid by the railroad company, but they were detached from the bonds and cashed by other parties. They were regarded by the court as having a special equity. "It was through the advance of money to cash those coupons in the hands of the holders of the bonds to which they belonged, that such holders obtained the money for those coupons. On such advance, those coupons passed into the hands of those who now hold them. But for such advance, the coupons, in the hands of the original holders of them, would not have been worth their face value, as they were made to be by such advance. The original holders of such coupons must be regarded as still holding the bonds to which such coupons belonged, or, if not, those who hold such bonds and subsequently maturing coupons belonging thereto must be held to be subject to the same equities with such original holders. No special reasons are shown, in the evidence, why, as against any of such holders, the present holders of coupons of July first, 1873, are estopped from claiming priority. Those who had their coupons of July first, 1873, cashed by means of such advance, retained the money, and to permit them now to exclude the holders of such cou-

thereof,' may very well be held to embrace the payment of interest, according to the times of the semi-annual recurrences of interest, and in such order. Certainly, there is nothing in these words, or elsewhere in the mortgage, that forbids a course which is absolutely necessary, unless a result is to be effected which will not be a payment of interest according to the tenor of the bonds, but will leave some part of a given instalment of interest paid in full, and the rest of it not paid in full. In the case of Dunham v. Cincinnati &c. Railw. Co. 1 Wall. (U. S.) 254, the mortgage provided that, in case of default and a sale, all bonds, and the interest accrued thereon, should be equally due and payable, and entitled to a pro rata dividend of the proceeds of sale. Hence it was held that there could be no preference of past-due coupons over the principal of the bonds. No case was cited on the argument which decides the above question adversely to the view I take. Most of the cases cited were not cases of coupons or interest on numerous bonds secured by mortgage, and none of them were cases where some interest in a given class had been paid and the rest not paid, and the fund was insufficient to pay all the principal and interest due. The case of Sewall v. Brainerd, 38 Vt. 364, was not such a case, nor was the case of Miller v. Rutland &c. R. Co. 40 Vt. 399; 94 Am. Dec. 413; and, in the latter case, no preference was claimed."

pons from being paid in full, and put on an equality with the registered interest of July first, 1873, which was paid in full, would be to permit them to work an inequality which would be unjust."[44]

§ 648. **One who holds bonds as collateral security should receive only the amount of his loan** and interest, and not the full amount of the bonds or of the dividend upon them.[45] This principle was applied to a case where a person authorized to raise money on the negotiable bonds of a corporation borrowed money on his own note, and pledged bonds to the lender, and applied the money to the use of the corporation. In a distribution of the proceeds of a foreclosure sale, the lender was not allowed to receive the full amount of the bonds and to account to the person who negotiated them, but was only entitled to his loan and interest.[46]

§ 649. **Upon the foreclosure of a railroad mortgage, no part of the proceeds of the forclosure sale can be distributed among the stockholders** of the corporation, in accordance with any previous arrangement between them and the mortgagees, as against the general creditors not secured by the mortgage. Subject to the lien of the mortgages, the property of the road is in the corporation; and if anything remains upon a foreclosure of a mortgage after discharging the mortgage liens, it belongs to the corporation as a trust fund for the benefit of its general creditors, and does not belong primarily to its stockholders. The stockholders are not entitled to receive anything from a distribution of the proceeds of a foreclosure sale. The corporation is entitled to the surplus after the payment of its debts, and the stockholders are entitled to a share of the surplus only after the payment of all the debts of the corporation.

These principles are illustrated by a case decided by the Supreme Court of the United States upon appeal from the Circuit Court for Iowa.[47] The Mississippi and Missouri Railroad Company, having

[44] See §§ 247–255.

[45] See § 394; Morton v. New Orleans &c. R. Co. 79 Ala. 590, 621.

[46] Rice's Appeal, 79 Pa. St. 168. See Peck v. New York &c. R. Co. 59 How. Pr. (N. Y.) 419.

[47] Railroad Co. v. Howard, 7 Wall. (U. S.) 392. To same effect, see Chattanooga &c. R. Co. v. Evans, 66 Fed. 809.

incumbered its property by five several mortgages securing bonds to the aggregate of $7,000,000, a sum greatly exceeding the value of the property, became insolvent, and the Chicago and Rock Island Railroad Company made overtures for the purchase of the road, offering to give for it $5,500,000, a sum more than its value, upon the condition of getting title at once. The only way of accomplishing this seemed to be by a foreclosure of one of the mortgages; and as it was supposed that it was in the power of the stockholders to delay the foreclosure, an arrangement was made between the stockholders and the mortgagees, whereby the different classes of bondholders were to receive specified amounts, ranging from thirty to one hundred per cent. of the amount of their bonds, and the stockholders were to receive sixteen per cent. of the par value of their stock, amounting to $552,400, but no provision was made for the payment of the general creditors of the company. Pursuant to this agreement the property was sold under foreclosure, and the purchaser conveyed it to the Chicago, Rock Island and Pacific Railroad Company, a new corporation formed under the laws of Iowa to supersede the two companies before named. Before the sum arranged for division among the stockholders was distributed, certain judgment creditors of the first-named company appeared as claimants of this fund. The court held that this arrangement was fraudulent as against general creditors of the company, who were entitled to the undistributed fund; and it was regarded as immaterial that the property was mortgaged for more than it was worth, and that if it had been sold under an ordinary foreclosure, without any arrangement between the mortgagees and stockholders, the whole proceeds of the sale would have belonged to the mortgagees.

§ 650. **Any surplus of proceeds of a foreclosure sale remaining after satisfying the mortgage** for the payment of which the sale was made belongs to the holders of subsequent liens upon the property, and in absence of such, to the corporation owning the equity of redemption.[48] In the hands of the corporation such surplus is subject to its unsecured debts. The corporation takes it as a trust for its general creditors, and its stockholders have no claim upon it until all its debts are satisfied. In this respect the rule is the same,

[48] See 2 Jones Mortgages, §§ 1684–1698.

although the sale be made in pursuance of an arrangement between the mortgage bondholders and the stockholders, whereby the bondholders were to receive eighty-four per cent. of the proceeds in full satisfaction of their bonds, and the remainder was to be distributed among the stockholders. The lien of the mortgage being discharged by the payment of such percentage as a compromise, whatever remains of the mortgaged property belongs to the corporation, and is subject, like its other assets, to the payment of its debts. To a creditor's bill to prevent the distribution of such fund among the stockholders of the corporation before its debts are paid, and to subject the fund to the payment of its debts, the stockholders are not necessary parties. The corporation holds the fund in trust for the benefit of its creditors in the first instance, and for the benefit of its stockholders secondarily.[49]

Where there are prior liens as to a part of the property, and other claims involved, it is proper for the foreclosure decree to provide that any surplus, after paying the bondholders known, should be brought into court, to be subsequently distributed, under the direction of the court, to the holders of bonds and liens entitled to it, reserving all questions as to rights in the surplus for subsequent consideration.[50]

A cash amount paid by a bondholders' committee to the trustee on a foreclosure sale to pay off such bondholders as fail to come into the reorganization, does not revert to the committee in case all bonds are brought into the reorganization plan. Such fund is held by the trustees for the benefit of the original mortgagor, and passes to a new corporation which is its legally qualified successor.[51]

V. *Setting aside of Sale.*

§ 651. Proceedings to set aside as fraudulent a decree of foreclosure and a sale under it, must be commenced within a reasonable time after such sale. Courts of equity may refuse relief on account

[49] Railroad Co. v. Howard, 7 Wall. (U. S.) 392.

[50] Chicago &c. Co. v. Peck, 112 Ill. 408.

[51] Gray v. Mass. Cent. R. Co. 171 Mass. 116; 50 N. E. 549.

of the staleness of the claim, although no statute of limitations governs the case.[52] What length of delay will defeat a recovery must depend upon the particular circumstances of each case. The Supreme Court of the United States in one case held that a suit commenced five years after a sale under a railroad mortgage did not show a sufficient degree of diligence to justify the overthrow of the decree of foreclosure.[53] If ignorance of the frauds be alleged as an excuse for the delay, the bill should show specifically when the knowledge of the frauds was first obtained, or should give a satisfactory reason why such knowledge was not sooner obtained.[54]

When a suit is brought to set aside as fraudulent a foreclosure sale after a long delay, the cause of the delay should be specifically set out. An allegation in general terms of ignorance of the fraudulent acts and arrangements relied upon is insufficient. It must appear by allegation and proof that the complainant has not slept too long upon his knowledge of the fraud.[55]

Mortgagors may obtain relief from a fraudulent sale if they apply for it within a reasonable time after discovering the fraud. Thus, where a mortgage trustee received a bribe from the purchasers at the sale to induce him to act in their interest, and the mortgagors remained ignorant of this for eight years, a bill brought within two years after the discovery of it was deemed to be within a reasonable time.[56]

Laches need not be pleaded. If the cause as it appears on the

[52] Sullivan v. Portland &c. R. Co. 4 Cliff. (U. S.) 212; 94 U. S. 806; Wood v. Carpenter, 101 U. S. 135, 139, 143; Coddington v. Railroad Co. 103 U. S. 409; Landsdale v. Smith, 106 U. S. 391; 1 Sup. Ct. 350; Foster v. Mansfield &c. R. Co. 36 Fed. 627; 36 Am. & Eng. R. Cas. 281 (1888); Hayward v. Eliot Nat. Bank, 96 U. S. 611.

[53] Harwood v. Railroad Co. 17 Wall. (U. S.) 78. See 2 Jones Mortgages, § 1674; Foster v. Mansfield &c. R. Co. 36 Fed. 627; 36 Am. & Eng. R. Cas. 281 (1888).

[54] Harwood v. Railroad Co. 17 Wall. (U. S.) 78.

[55] Harwood v. Railroad Co. 17 Wall. (U. S.) 78.

[56] White Mountains Railw. v. White Mountains Railw. 50 N. H. 50; and see Sullivan v. Portland &c. R. Co. 4 Cliff. (U. S.) 212; 94 U. S. 806, affirming 4 Cliff. (U. S.) 212. Any considerable delay should be explained by averments contained in the petition, followed by proof of the averments. Farmers' &c. Co. v. Green Bay &c. R. Co. 6 Fed. 100.

hearing is liable to the objection, the court will refuse relief, though it be not set up by demurrer, plea, or answer.[57]

§ 651a. **Jurisdiction of federal court.**—A bill in equity in a federal court to set aside a final decree of that court against a corporation in a foreclosure suit, upon the ground that the decree was obtained by collusion and fraud, and that the court had no jurisdiction to make it, is an ancillary proceeding and a continuation of the main suit, so far as the jurisdiction of the Circuit Court as a court of the United States is concerned.[58]

§ 652. **A single stockholder may maintain a bill in behalf of the corporation to set aside a sale** as fraudulent, upon the refusal of the corporation and of the stockholders to do so.[59] But stockholders or other parties in interest who ask the court to set aside a sale made by a trustee to himself, or to an association of which he is a member, must come into court without delay. They cannot wait till new equities arise; or till they see that the purchasers, by improving the property, are likely to make it valuable.[60] Acquiescence by the stockholders for a year and half, when they had the means of knowing the acts complained of, has been held to preclude them from obtaining any relief in equity.[61]

In an action to set aside a foreclosure decree for fraud in the organization of the corporation in respect to the giving of the mortgage, the corporation is the proper party plaintiff rather than the individual subscribers to stock.[62] The right of a stockholder to maintain a bill is dependent on the refusal of the corporation to take action.

§ 652a. **A trustee cannot set aside a foreclosure sale obtained by bondholders** pursuant to a power conferred by a special act of legislature. After such action the trustees hold only a dry trust, with-

[57] Credit Co. v. Arkansas Cent. R. Co. 5 McCrary (U. S.) 23; 15 Fed. 46.

[58] Carey v. Houston &c. R. Co. 161 U. S. 115; 16 Sup. Ct. 537.

[59] Foster v. Mansfield &c. R. Co. 36 Am. & Eng. R. Cas. 281.

[60] Twin-Lick Oil Co. v. Marbury, 91 U. S. 587, 591; Kitchen v. St. Louis &c. R. Co. 69 Mo. 224.

[61] Graham v. Birkenhead &c. R. Co. 2 Mac. & G. 146.

[62] Ex-Mission &c. Co. v. Flash, 97 Cal. 610; 32 Pac. 600.

out beneficial interest, with no duties to perform, except to release and transfer the bare legal title which they held under the mortgage. This they must do on payment of any amount that may be due them for services or disbursements. As to them and their office, the mortgage is *functus officio*.[63] The trustee under such circumstances cannot maintain a writ of entry against a new corporation formed by the bondholders.[64]

§ 653. **After confirmation of a sale,** holders of mortgage bonds will not be allowed at a subsequent term to be made parties to the original foreclosure suit, so that they may impeach the sale and confirmation as fraudulent, although the power to make further orders is expressly reserved in the decree. The proper remedy of bondholders in such cases is by original bill.[65] After a conditional confirmation with such reservation, the court still has full control.[66]

Where the receiver had agreed with the holder of a paramount lien upon a portion of the road to pay his claim out of the proceeds of a foreclosure sale about to be made, and the road was sold as an entirety, and the sale was confirmed, the court reserving to itself the power to make further orders respecting claims, rights, or interests in or liens on the property, upon the intervention of the holder of the paramount lien at a subsequent term the court will not set aside the confirmation of sale and cancel the deed to the purchaser, but will afford the intervening lien-holder protection by ordering a resale of the property in satisfaction of his claim.[67]

§ 654. **The right of a corporation to avoid a sale of its property, by reason of the fiduciary relations of the purchaser,**[68] must be exercised within a reasonable time after the facts relating to it are known, or can by due diligence be ascertained. What this time is has never been held to be any determined number of days or years

[63] Somerset R. Co. v. Pierce, 88 Me. 86; 33 Atl. 772.

[64] Pierce v. Ayer, 88 Me. 100; 33 Atl. 777.

[65] Wetmore v. St. Paul &c. R. Co. 1 McCrary (U. S.) 466; 5 Dill. (U. S.) 531; 3 Fed. 177.

[66] Farmers' &c. Co. v. Burlington &c. R. Co. 32 Fed. 805; Burnham v. Bowen, 111 U. S. 776; 4 Sup. Ct. 675; Farmers' &c. Co. v. Newman, 127 U. S. 649; 8 Sup. Ct. 1364.

[67] Farmers' &c. Co. v. Newman, 127 U. S. 649; 8 Sup. Ct. 1364.

[68] See 2 Jones Mortgages, §§ 1636, 1876–1888.

as applied to every case, like the statute of limitations, but must be decided in each case upon all the elements of it which affect that question. These are generally the presence or absence of the parties at the place of the transaction, their knowledge or ignorance of the sale, and of the facts which render it voidable, the permanent or fluctuating character of the subject-matter of the transaction as affecting its value, and the actual rise or fall of the property in value during the period within which this option might have been exercised.[69] Thus, a very much longer time might be allowed to assert this right in regard to real estate whose value is fixed, on which no outlay is made for improvement, and in the value of which there can be but little change, than would be allowed in respect to property which is subject to rapid, frequent, and violent fluctuations, such as mining property, or property adapted to the production of mineral oil from wells. Therefore, where a director of a corporation who was secured by a trust deed of such property purchased the property at a foreclosure sale under this deed, and the sale was fairly made, and all the facts on which their right to avoid the contract depended were immediately known to all the stockholders, who refused to join in the purchase, or to pay assessments then made on their stock, the corporation was not allowed, nearly four years afterwards, when the purchaser, taking all the risk, had made his investment profitable, to hold the purchaser as trustee of the property, and liable to account for the profits during the time he had been in possession of it.[70]

§ 655. A director of a corporation having in good faith made a loan to it, and taken security in the form of a deed of trust of real estate, may properly purchase the property at a sale under the power. He is not in such case both seller and buyer. When a trustee is interposed who makes the sale, and who has the usual powers necessary to see that the sale is fairly conducted, he is in this respect the trustee of the mortgagor, and must be supposed to have been selected by him for the exercise of this power. The *cestui que trust* is at liberty to bid, subject to the rules of fairness, which are the more rigid in proportion as the relation he bears to the mortgagor

[69] Twin-Lick Oil Co. v. Marbury, 91 U. S. 587, per Miller, J.

[70] Twin-Lick Oil Co. v. Marbury, 91 U. S. 587, per Miller, J.

is the more confidential; for, if he could not bid, he would be deprived of the only means which his contract gave him of making his claim out of the security.[71]

It is not illegal for a director of a company to buy its securities directly of the company at a discount, provided he pays the same price at which they are issued to other persons; and therefore he is not liable to the company for the difference between the price paid and par. Such a purchase does not fall within the principle of equity which prohibits an agent, or director, or any person in a fiduciary character, and having power and influence in a company, from making a profit by his dealings with it.[72]

But the directors of a corporation, being trustees for its creditors, cannot obtain priority over a creditor by taking a mortgage to themselves to secure advances and indorsements made by them for the corporation after the creditor has brought suit, and while the corporation is insolvent.[73]

But a director, purchasing securities as trustee for his corporation, purchases at a foreclosure sale in the same capacity, and is not entitled to recover a discount he obtained from the face value of the security.[74]

A fair, open, public sale of corporate properties made pursuant to the provisions of a mortgage will not be set aside at the instance of creditors or stockholders, for the reason that directors of the corporation united with others in the purchase, where it appears that such directors were creditors and holders of bonds of the corporation, but did not procure or invite the sale, which was forced by other bondholders.[75]

[71] Twin-Lick Oil Co. v. Marbury, 91 U. S. 587; Lucas v. Friant, 111 Mich. 426; 69 N. W. 735. Ready v. Smith, 170 Mo. 163; 70 S. W. 484, resting in part on the ground that general creditors of a mortgagor could not raise such an objection, and that the right was barred by laches. See, also, Snedeker v. Ayers, 146 Cal. 407; 80 Pac. 511.

[72] Compagnie Générale de Bellegarde, in re, L. R. 4 Ch. D. 470.

[73] Olney v. Conanicut Land Co 16 R. I. 597; 18 Atl. 181; 5 L. R. A. 361; 27 Am. St. 767; and see Bradley v. Converse, 4 Cliff. (U. S.) 375; Stout v. Milling Co. 13 Fed. 802; Haywood v. Lumber Co. 64 Wis. 639; 26 N. W. 184.

[74] Kroegher v. Calivade Col. Co. 119 Fed. 641.

[75] New Memphis Gas Light Cases, 105 Tenn. 268; 60 S. W. 206; 80 Am. St. 880.

§ 656. A sale by a bondholder in fraud of other bondholders will be set aside. One holder of a few bonds out of a large amount issued by a corporation, and secured by a mortgage of its property, has no right to use the mortgage as an instrument by which he may become the owner of the mortgaged property at a grossly inadequate price, leaving the other bonds unpaid. It is his duty, if he makes use of the mortgage security at all, to make it productive of the most that can be obtained for all who are interested in it. Community of interest between the bondholders having a common interest in the same security involves mutual obligations. If one of them seeks to appropriate the security exclusively to himself, or to make a profit out of it at the expense of those whose rights in it are the same as his own, he is guilty of fraud.

These principles are illustrated in a case which came before the Supreme Court of the United States from Louisiana.[76] The Vicksburg, Shreveport and Texas Railroad Company, in 1857, issued bonds to the amount of $761,000, and secured them by a mortgage upon its railroad and franchises and personal property, together with more than four hundred thousand acres of land. On the 23d of December, 1865, the holder of four of the mortgage bonds, upon which coupons to the amount of $720 were due and unpaid, obtained from a judge of a court of the State of Louisiana, at chambers, an *ex parte* order of sale. His petition did not disclose the name of any other bondholder; and no notice to the other bondholders, the most of whom resided in other states, was asked for or given. The sale was fixed for the earliest possible day, the 3d of February, and the sheriff advertised the sale in one newspaper published in the town of Mon-

[76] Jackson v. Ludeling, 21 Wall. (U. S.) 616. See, also, 99 U. S. 513. It does not appear that the mortgage in this case was made to trustees for the bondholders. The mortgage, as well as the proceedings upon it, or upon the bonds, show peculiarities of the law of Louisiana different from the common and statute law of any other state in these respects. Under the practice in Louisiana, the proceedings upon a mortgage may be altogether ex parte. The mortgage being regarded as in the nature of a confession of judgment, the judge grants an execution as a matter of course upon the production of the bonds secured, and authentic evidence of the mortgage. This process is known under their Civil Code as executory process. See, in this connection, New Orleans R. R. v. Morgan, 10 Wall. (U. S.) 256.

roe, and by posting a copy of the advertisement on the church door, and another at the door of his office. By a law of the state the property seized was required to be appraised, and could not be sold for less than two-thirds of its appraised value. It consisted of a railroad about one hundred and ninety miles in length, with numerous stations, buildings, warehouses, depots, and depot grounds, cars, locomotive engines, wagons, machinery, utensils, bills receivable to the amount of more than $40,000, unpaid stock subscriptions exceeding $320,000, and a large land grant of several hundred thousand acres, together with the franchise of the company. The appraisers met to appraise this property only on the day of sale. They were appointed by the plaintiff in the suit, and by the acting president of the road, upon whom service had been made, both of whom became purchasers at the sale. The entire property was appraised at $75,000, and the sale proceeded. The sheriff exacted an illegal and onerous condition, that the purchasers should pay cash to meet the interest coupons then due, and should give security for the credit portion of the bid which covered the immature interest and bonds. The property was struck off for $550,000, but the bidder failing to pay at once the interest coupons then due and presented, the sheriff immediately set up the property again in bulk, and sold for $50,000 property upon which had been expended nearly $2,000,000, together with a large stock subscription, a large grant of lands, and considerable movable property. It appeared that the bondholder who instituted the proceedings, and several persons who became the purchasers at the sale, had entered into an agreement and combination to divest the company of its property and obtain it themselves at a sacrifice. Several of them were directors and other officers of the road. After the sale they entered into possession of the property and organized a new corporation. The other bondholders, who resided principally in other states, then brought a bill in equity to set aside the sale. The Supreme Court of the United States, in setting aside the sale, declared that the property was sacrificed by means of an unlawful and widespread combination, and that the directors who were parties to it were guilty of an inexcusable violation of confidence. The fraud and trust were entirely outside the record. The sale was conducted under the forms of law. The irregularity of the proceeding was in the fraudulent combination to deprive the great body of the

bondholders of their property in the road for the benefit of persons in whom, from their official connection with the road, or from their community of interest, these bondholders had the right to rely for faithfulness to trusts and to common obligations.

§ 657. A mortgage trustee in possession cannot without express authority become a purchaser. Inasmuch as a trustee having the possession and management of a railroad corporation for the protection of bondholders is a trustee not only for them, but for the corporation which made the mortgage, he cannot properly purchase the mortgaged property at a foreclosure sale even under a subsequent mortgage: and if he does so purchase the property, the corporation may redeem it upon paying the amount of his bid with interest thereon: and the trustee will be required to account for the earnings of the property while it was in his possession. In such case the corporation is entitled to have the account stated, and a reasonable time allowed for redemption after the balance has been ascertained.[77]

§ 658. A mortgage trustee may purchase at a foreclosure sale in pursuance of a provision in the mortgage that the trustee may purchase upon the request of a majority of the bondholders, and that no bondholder should have any claim upon the property or the proceeds thereof, except for his pro rata share of the proceeds as represented in a new corporation to be formed for the benefit of the bondholders. But under such a provision the new company must be one organized exclusively of the former bondholders. If the trustee afterwards sells the property to a new corporation, many of the incorporators of which are not bondholders of the first company, for a small part of the sum for which he bought the property at the foreclosure sale, a bondholder who is not an incorporator in the new company may recover from him his proportionate share of the proceeds of the foreclosure sale.[78]

§ 658a. A purchase by a receiver in his own name of a certificate

[77] Racine &c. R. Co. v. Farmers' &c. Co. 49 Ill. 331; 95 Am. Dec. 595; Ashhurst's Appeal, 60 Pa. St. 290; Kitchen v. St. Louis &c. R. Co. 69 Mo. 224.

[78] James v. Cowing, 17 Hun (N. Y.) 256; 82 N. Y. 449; Etna &c. Co. v. Marting &c. Co. 127 Fed. 32.

of sale on foreclosure of the property which was the subject of the receivership, will, at the election of the parties interested, be deemed a redemption for their benefit, and the title thus acquired to be held in trust for them, subject to the receiver's right to reimbursement for advances.[79]

§ 659. **The fact that the purchaser at a foreclosure sale of the property of a railroad company are bondholders and creditors** of the company, who have entered into an agreement to make the purchase and to reorganize the company, does not of itself affect the validity of the sale,[80] or subject the property in their hands to any trusts in favor of other creditors.[81] Such creditors of the corporation are *bona fide* purchasers, unless there be something else to destroy their character as such. The doctrine recognized in Railroad Co. v. Howard,[82] that equity regards the property of a corporation as held in trust for the payment of the debts of the corporation, and that it may be pursued by the creditors into whosesover possession it may be transferred, unless it has passed into the hands of a *bona fide* purchaser, has no application to a case where the purchasers occupy no relation of trust toward the corporation or its other creditors, and are in no respect incompetent to purchase and hold the property in their own right, and to agree among themselves as to the disposition to be made of it. Such purchasers occupy the position of *bona fide* purchasers when there is no fraud in their agreement to make the purchase and reorganization, and the stockholders of the old company derive no benefit from it, and the foreclosure and the sale under it are regular and fair.[83]

Neither is a creditor to whom the old company was under obligation to deliver additional bonds, but to whom they never were delivered, for this reason entitled to share in the benefits of such purchase by an association of bondholders. Although as between the old company and the creditor equity would consider that done which

[79] Shadewald v. White, 74 Minn. 208; 77 N. W. 42.

[80] Thornton v. Wabash R. Co. 81 N. Y. 462; Pennsylvania Transportation Co.'s App. 101 Pa. St. 576.

[81] Wetmore v. St. Paul &c. R. Co. 1 McCrary (U. S.) 466; Kropholler v. St. Paul &c. R. Co. 1 McCrary (U. S.) 299.

[82] 7 Wall. (U. S.) 392.

[83] Vose v. Cowdrey, 49 N. Y. 336; and see Ashhurst's Appeal, 60 Pa. St. 290.

ought to have been done, this rule does not affect the rights of bondholders who made their agreement and purchase in reference to what the company had actually done, and especially where the creditor seeking to establish this equity against the bondholders was himself, as an actual holder of some of the bonds, a party to the contract.[84] Bondholders who have become parties to a scheme for the purchase of the mortgaged road and the formation of a new company, and have in pursuance thereof surrendered their bonds in exchange for stock and bonds of such new association, are not in a position to take exception to the foreclosure sale.[85]

§ 660. **The solicitor of a railroad company may purchase its property at a foreclosure sale,** made pursuant to a decree in a foreclosure suit, though the purchase be made for the bondholders. While such a purchase will be scrutinized, it will be sustained if no injustice be done to his client. If the company consent to the sale, and a decree provides for a purchase by the bondholders, there is no harm in the solicitor's taking the title for their benefit, and the purchase is not inconsistent with his duties to the company.[86]

§ 661. **A foreclosure sale which has been assented to by the parties in interest cannot afterwards be questioned by them.** Thus a railroad mortgage was foreclosed and the property bought in by the trustee. The bondholders organized themselves into a new company for the purpose of operating the railroad. It appeared that all the bondholders had become members of the new company, or, by their silence or waiver of their claim, assented to the purchase. It was held, in a second suit to foreclose the mortgage, that the first foreclosure was valid, and divested the trustee of title, and of his right to bring a second suit on behalf of the bondholders, although he himself had purchased at the sale under the previous foreclosure.[87]

[84] Vose v. Cowdrey, 49 N. Y. 336.

[85] Crawshay v. Soutter, 6 Wall. (U. S.) 739.

[86] Pacific Railw. Co. v. Ketchum, 101 U. S. 289.

[87] Barnes v. Chicago &c. R. Co. 122 U. S. 1; 7 Sup. Ct. 1043, 1051, affirming 8 Biss. (U. S.) 514. Chief Justice Waite, delivering the opinion of the court, said: "The material question thus presented is whether the bondholders consented to what was done by the trustee in their behalf. If they did, it matters not that some have omitted to surrender their bonds for cancellation, and take certificates of stock in exchange. If they assented to

If, after a foreclosure sale of a railroad and purchase for the benefit of creditors, subsequent judgment creditors obtain a decree setting aside the foreclosure and giving their judgments priority, the decree invalidates the foreclosure only as to the creditors who obtained such decree, and not as to bondholders who assented to the sale and voluntarily took stock in a new company formed by the purchasers.[88]

§ 662. **Inadequacy of price** is not a sufficient ground for setting aside a sale, unless the inadequacy be such as to show that it is not the result of fair dealing and an honest purchase.[89] Moreover, when it is sought to set aside a sale for inadequacy of price, it must be shown that some person who is responsible will make an advance bid.[90]

§ 663. **Purchasers of a railroad at a foreclosure sale, who have conspired with the directors of the road in effecting a fraudulent sale,** will be held as trustees for the benefit of the parties in interest to the full value of the property purchased. The Milwaukee and Superior Railroad Company made its promissory notes, indorsed by four of its directors, for the price of iron furnished for the road, and secured them by a pledge of its bonds for $42,000. Similar bonds to the amount of $280,000, which had never been issued, were sealed up and deposited with a firm, not to be issued until this debt

what was done, they became in law purchasers at the foreclosure sale, and, as such, stockholders in the company which was organized under the statute in their behalf to take the property from their trustee, and that, too, without any formal surrender of their bonds. Their stock was bound for the payment in money of their respective shares of the costs, charges, and expenses of the sale, and of the reorganization of the company, and of carrying the same into effect. If they wanted certificates of stock, they were required to surrender their bonds, and pay what was due from them on this account; but as bondholders, purchasing through their trustee, they became, by express terms of the articles of organization, stockholders in the new corporation, with a lien on their shares for their proportion of the expenses." See, also, Huston v. Clark; Huston's Appeal, 127 Pa. 620; 18 Atl. 419.

[88] Barnes v. Chicago &c. R. Co. 8 Biss. (U. S.) 514; James v. Railroad Co. 6 Wall. (U. S.) 752.

[89] Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 380.

[90] Turner v. Indianapolis &c. R. Co. 8 Biss. (U. S.) 380.

for iron had been paid, and twenty-seven miles of the road built. The company having built about five miles of road, became insolvent. Suit was thereupon brought upon the notes against the directors who had indorsed them. These directors then procured at their own expense a suit to be commenced to foreclose the mortgage. They also arranged with certain persons to purchase this claim, under an arrangement whereby the purchaser should acquire the entire property of the road. In furtherance of this plan the $280,000 of bonds were delivered, by resolution of the board of directors, of whom four constituted a quorum, to the holders of the notes, as additional security. These creditors had not asked for further security, and refused, at first, to receive the bonds, and in fact did not receive them till they had sold their claim. These bonds, then in the hands of the proposed purchasers of the road, were sold on short notice at public auction, and bought by themselves at a small price; and after the decree of foreclosure they presented these bonds before the master, who allowed them as a lien on the road. They then purchased the entire railroad and its property for $20,100, and afterwards stripped it of its iron and all other movable property, which they sold and realized large sums of money for. Other creditors obtained judgment against the company, and brought a bill alleging the sale to be fraudulent, and seeking to reach the franchises and property. The Supreme Court of the United States held the purchasers to be trustees of these creditors for the value of the property less the sum actually paid for a lien upon it, and chargeable with interest on the difference from the day of sale. The scheme to acquire the property of this corporation was characterized as fraudulent in its inception, and fraudulent at every step in the progress of its execution.[91]

§ 663a. **Where stockholders in the mortgagor corporation appear to obtain some benefit in the purchasing company** at a foreclosure sale and general creditors are left out, the transaction is subject to the closest scrutiny by the court. But the mere fact that stockholders under the purchasing agreement be given some interest in the new company in exchange for their stock, while indicative of fraud,

[91] Drury v. Cross, 7 Wall. (U. S.) 299. See Merrill v. Farmers' &c. Co. 24 Hun (N. Y.) 297.

is not fraud *per se,* and a general creditor cannot attack the sale without showing actual fraud, and that some surplus over the mortgage debt has been placed beyond his reach. The impeachment of the decree must be for actual and not merely for constructive fraud.[92]

It has been declared by the Supreme Court of the United States that no foreclosure proceedings can be rightfully carried to consummation which recognize and preserve an interest in the stockholders, without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. If the bondholder wishes to foreclose and exclude general unsecured creditors and stockholders, he may do so; but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors. This is based upon the familiar rule that the stockholders' interest in the property is subordinate to the rights of creditors.[93]

§ 664. A foreclosure sale will be set aside as fraudulent where it appears that the notice of sale misstated the sum due under the mortgage, as, for instance, by setting forth that the amount of the bonds secured was $2,000,000, with $70,000 interest, when in fact less than $200,000, was outstanding in the hands of *bona fide* holders for value, and the remainder had either not been issued at all or had been through fraud transferred to the directors at merely nominal prices. Such a notice is calculated to destroy all competition among bidders, and indeed to exclude from the purchase every one except those engaged in the perpetration of the fraud; and where the purchase at such sale is made in behalf of the bondholders, who organize themselves into a company, they will be perpetually enjoined from setting up any right or title under it; but the mortgage will remain as security for the bonds in the hands of *bona fide* holders for value.[94]

[92] Wenger v. Chicago &c. R. Co. 114 Fed. 34.

[93] Louisville Trust Co. v. Louisville &c. R. Co. 174 U. S. 674; 19 Sup. Ct. 827; 43 L. Ed. 1134; St. Louis Trust Co. v. Des Moines &c. R. Co. 101 Fed. 632.

[94] James v. Railroad Co. 6 Wall. (U. S.) 752; Barnes v. Chicago &c. R. Co. 122 U. S. 1; 7 Sup. Ct. 1043;

§ 665. A sale before default passes only the mortgage title. Under a mortgage or deed of trust in the usual form giving a power of sale upon a default in payment of the debtor's interest secured, a sale before such default is not effectual in cutting off the right of redemption. It can confer nothing beyond the legal title in trust for the benefit of the grantor. A purchaser is put upon inquiry to ascertain whether there has been a default, and whether the default still exists at the time of the sale.[95]

§ 666. The trustee who obtained the decree of sale should be made a party to a suit in equity brought by stockholders of a railroad company to set aside as fraudulent proceedings regular on their face prosecuted by the trustee to foreclose it, after such proceedings have been completed. He must be given an opportunity to sustain his decree or to rebut the alleged fraud, and his absence is a fatal defect. "The judgments of courts of record would be scarcely worth obtaining if they could be thus thrown lightly aside."[96]

It may be necessary to make others besides the plaintiff in the original suit parties to the bill to set aside the sale. Thus the majority of the bondholders and stockholders of the Mississippi and Missouri Railroad Company having agreed to sell the road for a stipulated price, and to divide the proceeds among all the stockholders and creditors according to a plan agreed upon, and other stockholders and bondholders having refused to agree to the arrangement, in order to get around their opposition a sale was effected, through the action of the majority, by an amicable foreclosure of one of the five mortgages upon the road, the trustees in one of the mortgages being complainants, and those in the other mortgages, with the corporation, being defendants. The dissatisfied stockholders and bondholders then filed a bill against the purchaser and the corporation whose road had been sold, not making, however, any of the trustees or any of the consenting stockholders parties, charging collusion in the sale, and praying that it might be set aside. This bill was held by the Supreme Court of the United States fa-

30 Am. & Eng. R. Cas. 453. See 2 Jones Mortgages, §§ 1668–1681, 1906–1922; Equitable Trust Co. v. Fisher, 106 Ill. 189.

[95] Chicago &c. R. Co. v. Kennedy, 70 Ill. 350.

[96] Harwood v. Railroad Co. 17 Wall. (U. S.) 78.

tally defective for want of proper parties.[97] The proceeds of the sale had been distributed between the different sets of bondholders according to the agreement previously made between them. Their rights would therefore be effected by the suit to set aside the sale. The presence of the trustees of all these mortgages was therefore indispensable. To a bill to set aside a foreclosure sale under decree of court, the plaintiff in the foreclosure suit is a necessary party.[98]

§ 667. **Compensation to purchaser for repairs and improvements made by him.** In Louisiana one who has fraudulently purchased a railroad at a foreclosure sale, and is therefore a possessor in bad faith, is nevertheless entitled to compensation for putting it into working order. He is entitled to compensation for necessary repairs; and the reconstruction of a railroad and putting it in working order is so much in the nature of necessary repairs that, according to an equitable construction of the code, compensation for such reconstruction is to be made to him. He should not be allowed, however, for the cost of things which were consumed in the use; but only for the cost of such improvements as are in existence when the property passes out of his possession. He is entitled to interest on his expenditures for improvements, to an amount not exceeding the net earnings received from the property. He is accountable for the net earnings of the property, and has a lien upon them for the cost of the improvements.[99]

§ 667a. **Where the purchaser succeeds in having a sale set aside so as to be released from his obligation** to take the property, he is not entitled to an allowance for expenses and counsel fees in conducting such litigation. In such a proceeding the purchaser occupies an adverse position to the owners of the property, and the general rule that expenses for administering a trust fund in the hands of the court will be allowed, do not apply.[100]

§ 668. **Objections to a judicial sale, based upon errors in the de-**

[97] Ribon v. Railroad Companies, 16 Wall. (U. S.) 446.

[98] Harwood v. Railroad Co. 17 Wall. (U. S.) 78.

[99] Jackson v. Ludeling, 99 U. S. 513.

[100] Farmers' &c. Co. v. Green, 79 Fed. 222.

cree pursuant to which the sale was made, cannot be considered.[101] Thus, where a railroad has been sold by mortgage trustees under a decree, a bondholder, not a party to the action, cannot be heard on a motion to set aside the sale upon the ground of fraud between the trustees and the purchaser in procuring the decree of foreclosure, or that the trustees were interested in the purchase, and that the property was sold for a price grossly inadequate to its value.

Where mortgaged premises are ordered to be sold unless previous to the sale the mortgagor pays the amount found due by the referee, the referee's failure to report the amount found due on the bonds prior to the sale does not render the sale illegal. The mortgagor has no absolute right to have the sale set aside, and it cannot be said that the court below was without discretion to deny the application, or that it abused its discretion. Under such circumstances there is no jurisdiction to review the order on appeal.[102]

§ 669. **The legislature has no power to confirm a fraudulent sale** of the mortgaged property of a corporation. Retroactive statutes passed to cure defects in conveyances are purely remedial in their nature, their purpose being to correct mistakes, in order that the intention of the parties may be carried out; and they accomplish only what, upon principles of natural justice, a court of equity might decree. But such legislation cannot cure fraud in a sale.[103]

[101] Jones Mortgages, §§ 1587, 1588.

[102] Farmers' &c. Co. v. Bankers' &c. Co. 119 N. Y. 15; 23 N. E. 173.

[103] White Mountains Railw. v. White Mountains Railw. 50 N. H. 50, 57.

CHAPTER XXI.

RIGHTS OF PURCHASERS AT FORECLOSURE SALES UNDER CORPORATE MORTGAGES.

I. Purchasers are not liable for the debts of the old company, §§ 670–694.

II. Organization of purchasers into a new corporation, §§ 695–698.

I. *Purchasers are not liable for the Debts of the Old Company.*

§ 670. **There is no privity between a new corporation formed in accordance with statute authority by the purchasers of a railroad upon foreclosure, and the old corporation** whose property was foreclosed; and the new company is not liable for the debts of the old. Neither does the fact that the stockholders of the original company, by an arrangement subsequent to the purchase, were allowed to become stockholders of the new company without payment of any money, impose upon the new company the debts of the old.[1] There might be a preliminary agreement, or such an arrangement with the stockholders of the old company, or such admissions of liability as would charge the new company with a trust of the assets for the creditors of the old company. Such was the case of Railroad Company v. Howard,[2] where not only was there a preliminary agreement to sell the property to a particular company, and to make the proceeding to foreclose the mortgage ancillary to the agreement, but after the property vested in the purchaser, the latter admitted the possession of sixteen per cent. of the fund in hand to belong to the stock-

[1] Stewart's Appeal, 72 Pa. St. 291. [2] 7 Wall. (U. S.) 392.

holders of the old company; and the question being whether the stockholders or the creditors of that company should be entitled to this fund, it was, of course, held that the equity of the creditors was superior to that of the stockholders.

Corporate existence, and the right to exercise the power of eminent domain, can only be derived from legislative enactment; and before a company can demand a judgment condemning lands to its use, it must show that both have been conferred upon it by a valid law, and that it has substantially complied with the conditions which the law has annexed to the exercise of the power. The purchasers of a railroad upon a foreclosure sale, in the absence of a statute conferring upon them corporate powers, are not invested with any corporate capacity whatever. The foreclosure sale does not itself pass the franchise to be a corporation.[3]

§ 671. Purchasers of a railroad under a mortgage or execution sale are not regarded as continuing the old corporation.[4] The effect of legislation empowering the mortgage trustees and the bondholders, together with their associates, to purchase at a foreclosure sale the franchise and property of the old company, and investing them with all the corporate powers and privileges of the old company, but not giving the stockholders under the old any rights in the new company, is to create a new and distinct corporation, capable of owning and using that which is conveyed under the sale, and not to recognize the old company. Such new company takes what it purchases, subject to no liens or claims save such as may be paramount to the mortgage under which the sale is made.[5]

The corporation, as a legal entity, does not vest in the purchasers upon a sale under a mortgage, or by an assignee in bankruptcy, nor

[3] Atkinson v. Marietta &c. R. Co. 15 Ohio St. 21; and see Mendenhall v. West Chester &c. R. Co. 36 Pa. St. 145, note; State v. Rives, 5 Ired. (N. C.) L. 297; State v. Bank of Md. 6 G. & J. (Md.) 205; 26 Am Dec. 561n; Commonwealth v. 10th Mass. Tpk. Co. 5 Cush. (Mass.) 509; Bruffett v. Great Western R. Co. 25 Ill. 353.

[4] Vilas v. Milwaukee &c. R. Co. 17 Wis. 497; Smith v. Chicago &c. R. Co. 18 Wis 17; Commonwealth v. Central &c. R. Co. 52 Pa. St. 506; Memphis &c. R. Co. v. Railroad Commissioners, 112 U. S. 609; 5 Sup. Ct. 299; State v. Sherman, 22 Ohio St. 411, 428.

[5] Morgan County v. Thomas, 76 Ill. 120.

do they become corporators or stockholders in the corporation;[6] but by virtue of a statute the purchasers may immediately become a body corporate, with all the rights and privileges of the old corporation. The right to be a corporation, which the old corporation had, was not mortgaged, and did not pass by the sale; and the purchasers obtain such a right only upon forming a new corporation under the statute.[7] The franchise to be a corporation is not transmissible by a sale or mortgage, unless by force of some positive provision of statute it has been made so, and the mode in which the transfer may be effected is pointed out.[8] The statutory directions in regard to the organization of the new corporation may not be conditions of its being; and irregularities in the organization are not necessarily fatal to the being of the corporation under such a statute. The organization is but the creation of an agency by which the corporation can act, and presupposes the existence of the corporation.[9]

A subscriber to the stock of a road reorganized after a foreclosure sale of an uncompleted railroad cannot avail himself of conditions in the charter of the original road for the building of the road between certain terminal points, in order to obtain a release from his subscription. The new company is under no obligation to complete the whole road, but may take and use the road in the condition in which it was sold.[10]

A contract for the location of a terminal point by the old company is not binding on a purchaser at foreclosure. Such purchaser takes the property free and discharged from all such liens and contracts. If it were otherwise it would put an end to purchases of railroads.[11]

[6] Metz v. Buffalo &c. R. Co. 58 N. Y. 61; 17 Am. R. 201; and see Wellsborough &c. R. Co. v. Griffin, 57 Pa. St. 417; People v. Cook, 110 N. Y. 443; 18 N. E 113; 36 Am. & Eng. R. Cas. 256; McLeary v. Dawson, 87 Tex. 524; 29 S. W. 1044.

[7] People v. Cook, 110 N. Y. 443; 18 N. E. 113; 36 Am. & Eng. R. Cas. 256.

[8] Memphis &c. R. Co. v. Railroad Co. 112 U. S. 609; 5 Sup. Ct. 299; Commonwealth v. Smith, 92 Mass. 448, 455; 87 Am. Dec. 672; Hall v. Sullivan R. Co. 21 Law Reporter, 138; Chadwick v. Old Colony R. Co. 171 Mass. 239; 50 N. E. 629.

[9] Commonwealth v. Central &c. R. Co. 52 Pa. St. 506.

[10] Chartiers R. Co. v. Hodgens, 85 Pa. St. 501.

[11] Sherwood v. Atlantic &c. R. Co. 94 Va. 291; 26 S. E. 943; Hoard v. Chesapeake &c. R. Co. 123 U. S. 222; 8 Sup. Ct. 74.

Such a contract obligation is not a lien or charge upon the property of the railway company and does not devolve upon the purchaser of the property on foreclosure sale, or upon a new corporation organized under the statute to operate the road.[12]

§ 672. The franchise to maintain and operate a railroad is distinct from the franchise to be a corporation. The former may be mortgaged, and may pass to a purchaser at a foreclosure sale; but the franchise to be a corporation cannot be assigned. The franchise to be a corporation may survive after the corporation has parted with all its property, and everything that it can transfer. Even if a statute authorizes a corporation to mortgage its charter and property, it confers no right upon purchasers at a foreclosure sale to exist as the same corporation. If it confers any right of corporate existence upon the purchasers, it is only a right to reorganize as a corporation, subject to the laws in force at the time of the reorganization. The franchise to be a corporation remains in the old corporation, and may be exercised by it, notwithstanding the mortgage of its charter, until the new corporation is formed and organized, and the old corporation surrenders its franchise to be a corporation to the state.[13]

A grant of right of way through certain streets of a city or town is an assignable franchise. It will pass by a mortgage, and by a sale under foreclosure of the mortgage, and may be enjoyed by the purchaser.[14] Even where the franchise to use city streets is expressly declared to be non-assignable it may be mortgaged, but a purchaser at foreclosure sale would acquire no right to operate the road without the consent of the city.[15]

§ 673. The purchaser at a valid foreclosure sale takes the property free of all liens and incumbrances subsequent to the mortgage, in case the mortgage was duly recorded in all the counties in which the property was located. The title of the purchaser, as in

[12] People v. Rome &c. R. Co. 103 N. Y. 95; 8 N. E. 369.

[13] Memphis &c. R. Co. v. Railroad Co. 112 U. S. 609; 5 Sup. Ct. 299.

[14] New Orleans &c. R. Co. v. Delamore, 114 U. S. 501; 5 Sup. Ct. 1009; Chaffe v. Ludeling, 27 La. Ann. 607.

[15] Wells v. Northern Trust Co. 195 Ill. 288; 63 N. E. 136; affirming 90 Ill. App. 460.

the case of an ordinary mortgage, for the purpose of cutting off all intervening liens, relates back to the date of the record of the mortgage.[16] Taxes upon the real property of the corporation are a charge upon the land itself, regardless of existing incumbrances. Taxes upon personal property are not a charge upon any specific article. Taxes upon the capital stock of a corporation are taxes upon the personal property, and attach to its property subject to existing liens and encumbrances and upon a sale of the property under a prior mortgage, the purchaser takes the property free from the lien of such taxes.[17]

Under a statute making a judgment for personal injuries prior to the lien of a mortgage, a judgment for such an injury sustained after the recording of the mortgage is a lien superior to the mortgage; but a claim for such injuries under a pending suit is not a lien, and a purchaser at a foreclosure sale before such claim has been prosecuted takes free from such claim to judgment.[18]

The foreclosure sale, when confirmed by the court, and its conditions met by the purchaser, creates in effect a contract between the court and the purchaser and the court can no more impose an additional term or condition upon that contract than could an individual.[19]

All persons acquiring an interest in, or lien on, any part of the mortgaged property during the pendency of a foreclosure suit will be bound by the decree and sale made thereunder. The purchaser takes the property discharged from all such liens and interests, though the parties obtaining them be not parties to the suit; they must seek satisfaction from the proceeds of the sale and should become parties to the suit in order to bring their claims to the attention of the court.[20]

[16] Detroit v. Mutual &c. Co. 43 Mich. 594; 5 N. W. 1039; McKittrick v. Arkansas Cent. R. Co. 152 U. S. 473; 14 Sup. Ct. 661. A statute declaring no railroad mortgage shall be valid against a judgment for materials does not change the general rule, as it creates no lien in favor of such claims. Baltimore &c. Co. v. Hofstetter, 85 Fed. 75.

[17] Cooper v. Corbin, 105 Ill. 224.

[18] Burlington &c. R. Co. v. Verry, 48 Iowa, 458; White v. K. &c. R. Co. 52 Iowa, 97; 2 N. W. 1016.

[19] Chicago &c. R. Co. v. McCammon, 61 Fed. 772.

[20] Stewart v. Wheeling &c. R. Co. 53 Ohio St. 151; 41 N. E. 247; 29 L. R. A. 438.

§ 674. **A new corporation formed by purchasers is not liable for the debts of the old corporation,** to whose property and franchises it has succeeded by purchase and legislative authority, unless such debts have been expressly assumed, or the new corporation is the same corporate body as the old, having only a new name.[21] Thus, the St. Paul and Pacific Railroad Company was sued upon coupons made by the Minnesota and Pacific Railroad Company, under the allegation that, the latter company not having completed its road as required by statute, the name of the corporation was changed to that of the former company, which was really the old corporation under a new name. Judge Dillon, after an examination of the legislative and constitutional history of those corporations, was of opinion that it was not the legislative intention to continue the old corporation, but to create a new corporation, and to give it the property and franchises of the old corporation, so far as they were held by the state.[22]

A new company organized by the purchasers of a railroad upon foreclosure sale is not liable for the debts of the old company, though by statute the new company is clothed with the same powers as the old company.[23] The fact that the sale took place in pursuance of an agreement between the old company, which made the mortgage, its bondholders and the mortgage trustees, that a foreclosure sale should take place, and that the stockholders of the old company, and its unsecured creditors, should become stockholders in the new company, does not show that the new company formed by the purchasers is

[21] Lake Erie &c R. Co. v. Griffin, 92 Ind. 487; Taylor v. Atlantic &c. R. Co. 57 How. Pr. (N. Y.) 26; Ryan v. Hays, 62 Tex. 42; North Hudson R. Co. v. Booraem, 28 N. J. Eq. 450; Menasha v. Milwaukee &c. R. Co. 52 Wis. 414; 9 N. W. 396; 5 Am. & Eng. R. Cas. 300; Cook v. Detroit &c. R. Co. 43 Mich. 349; 5 N. W. 390; 9 Am. & Eng. R. R. Cas. 443; Cooper v. Corbin, 105 Ill. 224; 13 Am. & Eng. R. Cas. 394; Hopkins v. St. Paul &c. R. Co. 2 Dill. (U. S.) 396; Secombe v. Milwaukee &c. R. Co. 2 Dill. (U. S.) 469.

[22] Hopkins v. St. Paul &c. R. Co. 2 Dill. (U. S.) 396; and see Secombe v. Milwaukee &c. R. Co. 2 Dill. (U. S.) 469; North Hudson R. Co. v. Booraem, 28 N. J. Eq. 450; Sullivan v. Portland &c. R. Co. 4 Cliff. (U. S.) 212; 94 U. S. 806; Vilas v. Page, 106 N. Y. 439; 13 N. E. 743.

[23] Gilman v. Sheboygan &c. R. Co. 37 Wis. 317, 319; Vilas v. Milwaukee &c. R. Co. 17 Wis. 497; Wright v. Milwaukee &c. R. Co. 25 Wis. 46.

merely a reorganization of the old company, and does not enable a creditor of the old company to assert his claim against the new, except in pursuance of some agreement.[24] A creditor of the old company who has refused to become a party to the agreement for reorganization cannot impeach the foreclosure sale as illegal on the ground that the bondholders and stockholders united for the purchase of the property to prevent a sacrifice of it.[25]

There is no doubt that an agreement for reorganization might be made which would modify the effect which a foreclosure sale would otherwise have. But the natural effect of a foreclosure sale is not neutralized by facts which show merely an agreement for the formation of a new company, in which those interested in the old might become interested in a certain way.[26]

A judicial decree requiring a railroad to operate a certain line of road has been held to be binding on a new corporation formed to operate the property by purchasers at a foreclosure sale.[27]

§ 675. The effect of a sale of the property and franchises of a railroad company is not different from that of a sale under an ordinary mortgage. The purchaser does not thereby become liable to pay any of the debts of the mortgagor, though, if a prior lien exists upon the property, it may of course be enforced. It does not matter that the debt is a judgment for damages for land taken by the railroad company for its roadway, and that the purchasers at the foreclosure sale bought with notice of such outstanding judgment. The fact that the purchaser is operating the road across the lands of the plaintiff does not alter the case, so far as this question of liability upon the judgment is concerned. The plaintiff may have a remedy in another form of action, to compel the company to make compensation for his property, or stop running its cars over it. A court

[24] Smith v. Chicago &c. R. Co. 18 Wis. 17; Sullivan v. Portland &c. R. Co. 94 U. S. 806, affirming 4 Cliff. (U. S.) 212; Pennsylvania Trans. Co.'s App. 101 Pa. St. 576.

[25] Pennsylvania Trans. Co.'s App. 101 Pa. St. 576. But where the stockholders in the old corporation retain the same interest, it is a fraud upon an unsecured creditor, so that he can hold the new corporation for his claim. Central R. Co. v. Paul, 93 Fed. 878.

[26] Smith v. Chicago &c. R. Co. 18 Wis. 17.

[27] State v. Iowa Cent. R. Co. 83 Iowa, 720; 50 N. W. 280.

of equity would doubtless afford such remedy in a case where it appeared the new company elected to adopt the original taking, and continued to occupy and use the land for the purpose of its road; for the right of the original owner to compensation for his property is paramount, and it is idle to say that an unsatisfied judgment against an insolvent corporation afforded him any compensation. But the ground of liability of the new company is not the judgment against the old corporation, but is founded upon the principle that it has seen fit to adopt and ratify the original taking, and therefore is bound to make compensation.[28]

If a corporation transfers its property to another corporation, in order through a change of name to defraud its creditors, and the latter corporation makes a mortgage of the property so transferred, the lien of the creditors of the old corporation is superior to that of the mortgage bondholders with notice of the fraudulent purpose of the transfer.[29]

§ 676. **A purchaser with notice of a claim or lien of another upon the property** takes subject to such claim or lien, whatever that may be. Thus, where the purchaser at a foreclosure sale of a railroad, and telegraph line running along the line of the railroad, had notice of acts sufficient to put him on inquiry that the telegraph company claimed the telegraph property as personalty, and knew that the telegraph company was in possession and operating the telegraph line, and the records of the foreclosure suit under which the sale was made contained a recital of the contract under which the telegraph company claimed the property, it is sufficient notice to such purchaser that the telegraph company claimed an interest in that property, and he is not a purchaser for value and without notice.[30]

But a purchaser is not bound to look beyond what appears upon the face of the record, and anticipate a future claim for a mechanic's lien where parties have intervened and sought to enforce their claim for materials furnished or used in the construction of the roadway

[28] Gilman v. Sheboygan &c. R. Co. 37 Wis. 317. The case of Pfeifer v. Sheboygan &c. R. Co. 18 Wis. 155; 86 Am. R. 751, is distinguished, but so far as it conflicts is overruled.

[29] Blair v. St. Louis &c. R. Co. 22 Fed. 36.

[30] Western Union Tel. Co. v. Burlington &c. R. Co. 11 Fed. 1.

against the earnings of the road in the hands of the receiver, and afterwards claimed such mechanic's lien, only when such earnings proved insufficient to satisfy their claims.[31]

Where a railroad foreclosure decree provides that certain specified classes of claims constitute a prior lien to that of the mortgage bonds and directs that the sale shall be made subject to such lien one who purchases at the foreclosure sale is estopped from objecting to a payment of a claim which belongs to one of the classes specified.[32]

§ 677. **A new corporation is liable for claims which were an equitable lien upon funds received from the mortgage trustees,** who have operated the road for the bondholders. Thus a claim for damages to property by fire, communicated by a locomotive while passing along its track, while the road was operated by such trustees, is regarded as an incident to the operating of the road, and as a part of the running expense, and therefore an equitable lien upon the funds in the hands of the trustees. Therefore, if it be averred and proved that at the time of the injury the trustees had in their hands, or under their control, and that the new corporation received, such funds from them, the new corporation is liable in equity to the person suffering the damage.[33]

§ 677a. **Purchasers discharging liens against the property are not entitled to be subrogated** to the rights of the claimants. Thus where a fund is created by the sale of land not included in a railroad mortgage, bondholders purchasing at foreclosure sale are not entitled to apply to such fund for reimbursement because they have been compelled to meet expenses accruing during a receivership. The ground for this decision was that the decree of foreclosure charged such expense upon the purchasers and the bondholders were concluded by its terms. Such outstanding obligations became a part of the purchasers price to be paid for the property.[34]

[31] Hale v. Burlington &c. R. Co. 13 Fed. 203.

[32] St. Louis &c. R. Co. v. Stark, 55 Fed. 758.

[33] Stratton v. E. &c. R. 76 Me. 269. See, also, Union Trust Co. v. Morrison, 125 U. S. 591; 8 Sup. Ct. 1004.

[34] Morgan's &c. Co. v. Moran, 91 Fed. 22.

§ 678. **Subject to vendor's lien for purchase money.**—When, upon a purchase of a railroad by the bondholders, and a conveyance to a new corporation formed by them, a part of the purchase money remains unpaid, the new company takes and holds the property subject to the vendor's lien for such unpaid purchase money.[35] The subsequent consolidation of the reorganized company with another did not discharge the lien. The notice of the lien with which the first company was charged affected also the consolidated company.[36]

§ 679. **Damages resulting from the negligence of those operating a road after the time** the property of a railroad company is sold, and before the confirmation of the sale by the court, are not chargeable to the purchasers, unless they have taken actual possession of the property. Before the confirmation of the sale and conveyance of the property, the purchasers have no right to intermeddle with the road or any of the property purchased. If they do not in fact assume the control of the employes and servants of the road, they are not responsible for their negligence.[37] But after the sale has been completed, the purchaser is responsible for injuries resulting from the operation of the road, and the former company is no longer liable, for its power over the property has ceased, and with its power has also ceased its liability for the proper management of the road. If the purchaser does not become a corporation, but operates the road as an individual in his own name or as the former company, he cannot be sued in the name of that company, but the suit should be in his own name.[38]

§ 680. **There may be a condition precedent imposed by statute or decree that the new corporation shall assume the debt of the old.** When the purchasers of a railroad are incorporated under a special act which provides as a condition precedent to its operation that the new company shall pay all claims against the old corporation for work done and materials furnished, the new company, when it has

[35] North Carolina R. Co. v. Drew, 3 Woods (U. S.) 691.

[36] North Carolina R. Co. v. Drew, 3 Woods (U. S.) 691.

[37] Metz v. Buffalo &c. R. Co. 58 N. Y. 61; 17 Am. R. 201; Stratton v. European &c. R. 74 Me. 422.

[38] Wellsborough &c. Co. v. Griffin, 57 Pa. St. 417.

accepted the act and succeeded to the franchises of the old company, is liable for all such claims. The acceptance of the act amounts to an assumption of payment of all claims provided for in the condition. It is not necessary that the act should provide a specific remedy in favor of the creditors, whose claims the company is made liable for, because, whenever a statute imposes a duty or liability, the common law affords the remedy, either by an action of debt when the demand is for a sum certain, as in the case of a judgment, or otherwise by an action of assumpsit.[39] If the claim be in the form of a judgment against the old company, it is not necessary in an action upon it to aver that the judgment was well founded; for the presumption is that the judgment is correct.

A statute making the consolidated corporation liable for all debts of each company entering into the arrangement is .not retrospective in its operation, but is designed to apply only to companies consolidated after its passage.[40] And so, if the decree of sale provides that the purchaser shall pay all liabilities incurred by the receiver while in possession, the purchaser is bound to know that the title is based on the decree, and that such title and any title the purchaser can give is inferior to a judgment obtained on any such liability.[41] After a sale and confirmation to a new corporation under a decree which provides that the latter shall pay all the debts of the receiver, the purchaser cannot, after acquiring the property, be permitted to question the validity of the decree.[42]

§ 681. To prove a new promise by the purchasers of a railroad and its franchises to pay a debt owing the original company, there must be shown some action on the part of the directors from which a promise can be clearly inferred. An agreement to issue stock to the creditors of the former corporation, in case a reorganization should be effected, does not give rise to any claim on their part to payment in money; and a certificate by the secretary of the company that a certain amount was due a creditor of the old company

[39] St. Louis &c. R. Co. v. Miller, 43 Ill. 199; County Com. in re, 143 Mass. 424; 9 N. E. 756.

[40] Hatcher v. Toledo &c. R. Co. 62 Ill. 477.

[41] Central Trust Co. v. Sloan, 65 Iowa, 655; Wood v. Dubuque &c. R. Co. 28 Fed. 910.

[42] Farmers' &c. Co. v. Central R. Co. 17 Fed. 758.

would be insufficient to bind the new company, unless he had been empowered to adjust the claim.[43]

If a director of the new corporation has a personal interest in the contract of assumption entered into by its directors, it may be repudiated by the corporation; and in order to defeat it the corporation is not bound to show that the transaction was fraudulent or unfair: or to show that the influence of the director determined the action of the board.[44]

Where the indebtedness of a prior company is assumed, judgment creditors of that company do not thereby acquire an equitable lien upon the property sold, for the payment of their claims; they merely acquire the right to look for payment to the purchasing company. Of course if the judgments were liens by statute upon the property before it was transferred, they would remain liens upon it after the transfer.[45]

Where there were conflicting provisions as to whether a new corporation assumed the bonds of its predecessor as well as general indebtedness, the terms of the bill of sale of the property were held to be controlling, to the effect that the bonded indebtedness was not assumed.[46]

§ 682. Debts incurred by a corporation cannot be released by legislative enactment, whether they be debts incurred by contract, forfeiture, or penalty. A repeal of the charter of the corporation and a transfer of its powers to a different body cannot have this effect. The creditors of the corporation have still an undoubted right to enforce their claims. To release a corporation from its liabilities by legislative enactment would be to impair the obligation of contracts existing between it and its creditors; and this is a prohibited power. Moreover, the charter of a company is a contract with which the legislature cannot interfere without consent. A sale of its property does not disorganize it. It still continues a corporation so far as its creditors are concerned. Neither can the legislature transfer the in-

[43] American Cent. R. Co. v. Miles, 52 Ill. 174.

[44] Munson v. Syracuse &c. R. Co. 103 N. Y. 58; 8 N. E. 355.

[45] Hervey v. Illinois R. Co. 28 Fed. 169.

[46] Fernschild v. Yuengling Brew. Co. 154 N. Y. 667; 49 N. E. 151; affirming 15 App. Div. (N. Y.) 29.

debtedness of one corporation to another without the action of these bodies; and even then the corporation that incurred the indebtedness is not released without the consent of its creditors.[47]

§ 683. **Whether, upon a foreclosure sale of property subject to a mortgage, the purchaser can contest the validity of the mortgage,** depends upon the terms of the order of sale, or of the deed under it. In general it may be said that, under a sale by judicial process simply directing a sale of the debtor's property, the purchaser takes the property subject to any prior liens and incumbrances existing upon it, with a right, nevertheless, to contest the validity of apparent incumbrances, either as regards their legal existence or the amount due upon them. And so a sale by a receiver under an order directing a sale by public auction of the property of a corporation, "subject to all legal liens and incumbrances thereon," followed by an order of confirmation directing him to make a deed to the purchasers, "subject to all legal liens and incumbrances thereon," transfers the property subject to the lien of whatever incumbrances there may be upon it, with the right to contest their validity.[48]

§ 683a. **Ordinarily a transfer on foreclosure sale is made free from the lien of receivers' certificates.** A final decree in a foreclosure suit, whereby the purchasers at the sale are vested with the title free from all liens for receivers' debts, operates to set aside so much of a previous order authorizing the issue of receivers' certificates as made them a paramount lien on the road, and transfers the lien of the certificates, if any, to the proceeds of the sale. The holder of certificates is charged with notice that his security may be injuriously affected and is bound to advise the court of his claim.[49]

Receivers' certificates issued by authority of an order entered in

[47] Bruffett v. Great Western R. Co. 25 Ill. 353; Hatcher v. Toledo &c. R. Co. 62 Ill. 477.

[48] Hackensack Water Co. v. DeKay, 36 N. J. Eq. 548, 555. "An officer selling under judicial process has simply a naked power to sell according to the mandate of the court. He may adopt conditions of sale amply sufficient to secure compliance by the purchaser with his bid, but he cannot impose any liability upon the purchaser with respect to the property sold which would not result by law from his purchase." Per Depue, J.

[49] Mercantile Trust Co. v. Kanawha &c. R. Co. 58 Fed. 6.

a railroad foreclosure suit after an entry of a decree of sale plainly contemplating such sale free from liens, do not constitute a lien on the property after sale, but are a charge only upon the proceeds. The true rule is that where a sale is not expressly made subject to receivers' debts, the holders of such claims must depend for their ultimate rank and payment upon the final decree made in the cause in which they were issued.[50] But the court may properly make a decree ordering the property to be sold expressly subject to outstanding obligations of the receiver, and requiring the receiver to file a statement thereof in detail.[51]

§ 684. Purchasers at a foreclosure sale made expressly subject to the payment of receivers' certificates cannot question their validity on the ground that the receiver negotiated them collusively, and with less benefit to the trust fund than should have been obtained. The purchasers have no interest in the trust fund represented by the certificates, and it is immaterial to them whether they were or were not negotiated on fair terms, and for the best interests of the fund.[52] The purchasers are estopped by the terms of the deed from setting up such a defence. They can neither question the validity of the debt assumed, nor the amount for which the debt is declared to be a lien upon the property.[53]

Where a decree in a mortgage foreclosure provided that the sale of the mortgaged property should be made subject to the payment of all receivers' certificates which have been established as valid by prior decrees in the suit or by that decree, it was held that the purchaser at the sale could not contest the lien of certificates, the validity of which had been established by an interlocutory decree, even upon the ground of concealment and fraud subsequently discovered, by which, as was alleged, the decree had been obtained.[54]

But where receivers' certificates have been issued and pledged at the rate of ninety cents on the dollar, and the property was after-

[50] Columbus &c. R. Co. Appeals, 109 Fed. 177.

[51] Bound v. South Carolina R. Co. 58 Fed. 473.

[52] Central Nat. Bank v. Hazard, 30 Fed. 484.

[53] Jones Mortgages, § 1491. See Sheffield &c. R. Co. v. Newman, 77 Fed. 787.

[54] Swann v. Wright, 110 U. S. 590; 4 Sup. Ct. 235.

wards sold subject to liens established on references then pending, it was held that the pledged certificates were not liens to the extent of their face, but to the extent of the money actually advanced on the certificates.[55]

When the decree in a receivership suit provides that the purchaser at the receivership sale shall satisfy and discharge any unpaid liability and indebtedness of the receivers, jurisdiction to carry out that part of the decree is reserved in the court. To that extent the receivership case is still pending, and an action for the purpose of ascertaining and liquidating claims is properly brought against the receivers even after their discharge.[56]

§ 684a. **Where the decree of sale provided that all demands accruing during the receivership should be barred unless presented within six months** of the confirmation of the sale, but the decree of confirmation omitted the six months' limitation clause, the latter decree controlled. The purchaser might have appealed from the decree of confirmation because it varied from the decree of sale; it was within the discretion of the court to abrogate the six months' limitation, the fund being substantially a fund in court, and in any case the purchaser having failed to appeal was bound by the order.[57]

§ 685. **When purchasers bound by agreements made by receivers.** —Where in a deed to the receivers of a railroad company a covenant to build and maintain fences was by mistake omitted, the deed may be reformed and the covenant inserted as against the successors of the receivers, a reorganized company. But a verbal agreement of the receivers, that the grantor should receive an annual pass over the railroad during his life, is not binding upon the reorganized company, and the grantor can have no relief against the company for refusing to issue the pass: for the agreement of the receivers was only a verbal utterance so far as they themselves were concerned, and they could not bind their successors by such an agreement.[58]

[55] Swann v. Clark, 110 U. S. 602; 4 Sup. Ct. 241.

[56] Ohio Coal Co. v. Whitcomb, 123 Fed. 359. As to the nature of provisions in a decree, see Anderson v. Condict, 94 Fed. 716.

[57] Olcott v. Headrick, 141 U. S. 543; 12 Sup. Ct. 81.

[58] Martin v. New York &c. R. Co. 36 N. J. Eq. 109.

§ 686. A purchaser or mortgagee of the property of a new corporation which has assumed the debts of the old corporation, with notice of such assumption, takes the property subject to such charge, in the same way that the new corporation held it.[59]

Where an expenditure authorized to be made by a receiver is declared to be a first lien on the mortgaged premises and the proceeds thereof, upon the completion of a sale under the mortgage the lien is transferred to the proceeds of the sale; but the remedy is not confined to the proceeds; it may be pursued against the property which was the subject of the sale. If, for instance, the payment for the purchase is a constructive payment made by bondholders in the bonds of the company, the lien will attach to the property in the hands of the purchasers; for in such case there are no proceeds to which the lien could attach, and if it could not be enforced against the property it would be illusory merely. The bondholders are not purchasers for value without notice, and they take the property subject to the lien.[60]

§ 687. Combinations for the purpose of purchasing and reorganizing large properties, such as a railroad, are to be promoted and encouraged, if they are properly entered into without the intention of defrauding any party in interest, because such combinations are necessary to prevent sacrifice and loss, and to create competition. Therefore interrogatories filed in a foreclosure suit to persons who have formed an organization for the purpose of buying a railroad, respecting their acts, intentions, or purposes, are irrelevant.[61]

Mortgage bondholders and other creditors may lawfully combine to purchase a railroad at a foreclosure sale, provided it is no part of the agreement to prevent competition at the sale, or to use any unfair advantage.[62]

§ 688. A purchaser under a foreclosure sale who has agreed to purchase for the benefit of a new corporation to be organized by

[59] Blair v. St. Louis &c. R. Co. 24 Fed. 148; 25 Fed. 684.

[60] Vilas v. Page, 106 N. Y. 439; 13 N. E. 743.

[61] Robinson v. Philadelphia &c. R. Co. 28 Fed. 340.

[62] Kitchen v. St. Louis &c. R. Co. 69 Mo. 224; Marie v. Garrison, 83 N. Y. 14; 13 Abb. N. C. (N. Y.) 210.

those interested in the property, and to convey the property to such new corporation, in consideration that other parties in interest would withdraw their opposition, on the ground of the invalidity of the mortgage, to the foreclosure, will be compelled to fulfill his agreement, and he cannot set up the statute of frauds as a defense.[63] Such an agreement is not unlawful, as a collusive arrangement to establish a fraudulent debt, or as calculated to prevent competition in the bidding at the foreclosure sale.[64]

§ 689. Bondholders who purchase at a foreclosure sale under their mortgage have an equitable right to apply their bonds towards the payment of the purchase money, after satisfying the costs and charges of the litigation and trust.[65]

Where a trustee for bondholders has obtained an order to buy in the property for the full amount of the bonds, and one bondholder has appealed from the order on the ground that the bonds owned by him were guaranteed by the other bondholders, and that the effect of the order would be to deprive him of the benefit of his guaranty, a purchase under the order does not bind such bondholder, though he has filed no *supersedeas* bond to stay execution.[66]

A provision in a railroad mortgage, that in case the trustee should sell the mortgaged property upon default, the mortgage bonds should be received at a rate to be fixed in a certain manner, as part of the purchase price, is not binding upon the court in case foreclosure proceedings are instituted, and a sale is made under its direction. In the latter case the sale must be made according to the usual course of practice in judicial proceedings.[67]

Where the right to use bonds as purchase money has been established by a decree of court, the amount due on the bonds being specifically determined, and the application made, and a deed delivered on the faith of which money has been expended, other bondholders,

[63] Marie v. Garrison, 83 N. Y. 14; 13 Abb. N. C. (N. Y.) 210.

[64] Marie v. Garrison, 83 N. Y. 14; 13 Abb. N. C. (N. Y.) 210; Duncomb v. New York &c. R. Co. 84 N. Y. 190; 88 N. Y. 1, 11; Harpending v. Munson, 91 N. Y. 650; Munson v. Syracuse &c. R. Co. 103 N. Y. 58.

[65] Duncan v. Mobile &c. R. Co. 3 Woods (U. S.) 597.

[66] Sanxey v. Iowa &c. Co. 68 Iowa, 542; 27 N. W. 747.

[67] Farmers' &c. Co. v. Green Bay &c. R. Co. 10 Biss. (U. S.) 203.

who have had full notice, have no standing to petition the court to change the decree so as to correct an alleged inequality among the bondholders.[68]

§ 690. Unsecured creditors of an insolvent railroad company who refuse to come into a scheme of reorganization are without remedy. Even if the scheme provides that the stockholders of the old company shall receive stock in the new company in exchange at a certain ratio, while unsecured creditors are to receive second preferred income bonds at par for the full amount of the debts due them, it is not fraudulent and void as to the latter. Neither can such unsecured creditors complain of the scheme as inequitable because it provides that all who come into it shall contribute ratably to the expenses necessary to complete the reorganization.[69]

In case of a purchase for the benefit of the bondholders, a large majority of whom have agreed to a scheme of reorganization, the court may in its discretion allow the non-subscribing bondholders to participate in the purchase and reorganization on an equal footing with the others, provided they come in by a day named.[70]

§ 691. Bondholders after a foreclosure cannot claim an interest in a reorganized corporation without sharing in the expenses of the sale and reorganization. Thus, a foreclosure sale of a railroad being about to be made, several bondholders entered into an agreement to purchase and reorganize a company, but the agreement did not stipulate which of them should purchase, nor provide for the payment of expenses. One of the number undertook to buy at the sale, but the property was bid above his limit, and was sold to another, who afterwards, in consideration of advances made and of a prior indebtedness, transferred the title to the bondholder who intended to purchase. This bondholder began a reorganization, and invited the other bondholders to join in the payment of the expenses. This they declined to do, and afterwards filed a bill against the purchaser for an account; but it was held that, conceding the purchase

[68] Real Estate Trust Co. v. Perry County R. Co. 213 Pa. St. 57; 62 Atl. 25.

[69] Hancock v. Toledo &c. R. Co. 11 Biss. (U. S.) 148.

[70] Duncan v. Mobile &c. R. Co. 3 Woods (U. S.) 597.

of the road and its reorganization were made, in fulfillment of the agreement, for the benefit of all the contracting parties, yet the latter were debarred, by their refusal to share in the expenses, from claiming any interest in the purchase.[71]

Bondholders are entitled to be shareholders in the new corporation in the exact proportion of their respective debts against the old company. If one should insist upon receiving shares of stock greater in amount than his debt, the legal rights of the others would be invaded exactly so much; for the increase of one fraction correspondingly decreases the remainder of a whole. A bondholder cannot complain of any disposal made by the mortgagor of the bonds issued and sold to others, if there be no overissue; but he has a right to hold his aliquot share in the security, computed upon the whole amount of bonds issued and outstanding.[72]

§ 692. **A constitutional provision against issuing stock or bonds, except for money or property actually received** is not violated by a reorganization which provides for an issue of stock and bonds substantially the same in amount as that of the old corporation, although the amount of the stock alone is sufficient to cover the full value of the property, rights, and privileges of the reorganized company. The beneficial owners of the property had the right to fix the terms upon which they would surrender it to the corporation. It cannot be fairly said that the bonds so issued were issued without any consideration whatever actually received in property.[73]

§ 693. **Whether a purchaser at a foreclosure sale of the franchises, property, and immunities of a railroad company acquires a right of exemption from taxation,** which appertained to the corporation by its charter or by statute, depends upon the intent of the charter or statute which conferred such right of exemption. The general rule is that an exemption from taxation must be construed to have been the personal privilege of the very corporation upon which it was conferred, and that it ends with that corporation, un-

[71] Fidelity Insurance &c. Co.'s Appeal, 106 Pa. St. 144. See, also, Huston's Appeal, 127 Pa. 620; 18 Atl. 419.

[72] Lincoln Nat. Bank. v. Portland, 82 Me. 99; 19 Atl. 102.

[73] Memphis &c. R. Co. v. Dow, 120 U. S. 287; 7 Sup. Ct. 482.

less the express and clear intent of the law requires the exemption to pass as a continuing franchise to a successor.[74] In some Minnesota cases it was held that the charter of a corporation, when accepted, becomes a contract which cannot afterwards be impaired by legislative action unless the power to change the charter is reserved; that the immunity from taxation is an important element of the value of the corporate property and of the security; that a sale of the franchises and property of the corporation without the exemption would practically repeal the exemption, and restore to the state the right of taxation, which it did not have so long as the old company continued to be the owner of the property; but that if this exemption be regarded as a right appurtenant to the corporation to which it is granted, then the right will pass to a purchaser under a description of its franchises and property.[75]

The Supreme Court of the United States holds that immunity from taxation is not itself a franchise of a corporation which passes as such, without other description, to a purchaser of its property.[76] The exemption in one case was of the capital stock, works, workshops, warehouses, vehicles of transportation, and other appurtenances of the company.[77] It is certainly clear, as stated in that case, that

[74] Memphis &c. R. Co. v. Railroad Com. 112 U. S. 609; 5 Sup. Ct. 299; Railway v. Gill, 156 U. S. 656; 15 Sup. Ct. 484; Road Co. v. Sandford, 164 U. S. 587; 17 Sup. Ct. 201.

[75] St. Paul &c. R. Co. v. Parcher, 14 Minn. 297; Chicago &c. R. Co. v. Pfaender, 23 Minn. 217. So in Tennessee: State v. Nashville &c. R. Co. 86 Tenn. 438; 6 S. W. 880; 12 Lea (Tenn.) 583.

[76] Morgan v. Louisiana, 93 U. S. 217; approved in Wilson v. Gaines, 103 U. S. 417; Louisville &c. R. Co. v. Palmes, 109 U. S. 244; 3 Sup. Ct. 193; Memphis &c. R. Co. v. Railroad Com. 112 U. S. 609; 5 Sup. Ct. 299. See § 367. In this case the foreclosure proceedings were instituted by the state to enforce a statutory mortgage under a statute which provided for the sale of the road and its franchises, and declared that all the rights, privileges, and immunities appertaining to the franchise shall be transferred to, and vested in, the purchaser. The decree of sale also made the same provision. It was held that the state was estopped to tax the road in the hands of the purchasers under the foreclosure sale. They acquired with the property the immunity from taxation. See, also, Knoxville &c. R. Co. v. Hicks, 9 Baxt. (Tenn.) 442; Hand v. Savannah &c. R. Co. 17 S. C. 219.

[77] Morgan v. Louisville, 93 U. S. 217.

a purchaser of an engine or car from the company would not hold such property exempt from taxation. The case is to be distinguished from one where the entire road, franchises, and property of a railroad are exempted from taxation, and all its rights, property, and appurtenances are sold as a whole. The purchaser in such case acquires the right to use the property as the old company had the right to use it. Especially must this be the case when the sale is made under a statute expressly conferring on the purchaser the rights, privileges, and immunities of the corporation sold. Thus, the Knoxville and Ohio Railroad Company, whose charter contained an exemption from taxation, borrowed money from the State of Tennessee under its Internal Improvement Act, and a default having occurred, a statute was enacted vesting the Chancery Court at Nashville with jurisdiction of a suit to foreclose and enforce the state's lien, and to declare the amount of the company's indebtedness, and define the rights, duties, and liabilities of a purchaser of the state's interest in the road. This court decreed a sale of the property and franchises of the company, and that the sale should vest the purchaser with all the rights, privileges, and immunities appertaining to the franchises of the charter. The sale was made on the faith of the decree, and the Supreme Court of the state[78] held that the validity of the adjudication could not be questioned; that the exemption from taxation was a right for which a consideration had been given, and the exemption attached to the property; and moreover that, even if a new grant of immunity to the purchaser be regarded as necessary, the act of the legislature and the decree would probably be equivalent to such a grant.[79]

One who purchases a railroad under proceedings to enforce the statuory lien of a state, does not acquire an immunity from taxation which the railroad company possessed under its charter, in the absence of a statute or decree authorizing the transfer of such immunity. The statutory lien of the state was confined to the property owned by the company, or incident to, or necessary for, its business,

[78] Knoxville &c. R. Co. v. Hicks, 9 Bax. (Tenn.) 442; 15 Am. Railw. R. 197; 1 Tenn. Leg. Reporter, 338.

[79] See, also, Nichols v. New Haven &c. Co. 42 Conn. 103; Atlantic &c. R. Co. v. Allen, 15 Fla. 637; Gonzalez v. Sullivan, 16 Fla. 791.

and it cannot be presumed that more was sold than the lien covered.[80]

Where, however, a railroad chartered by the State of Missouri, having a like exemption, was foreclosed and sold to satisfy a statutory mortgage to the state, and was purchased by the state, the exemption was of course merged, because the exemption from the right of the state to tax the property would mean nothing when the state itself became the owner of the property. Therefore, when the state came to sell the road again, it could sell it with or without the right of redemption without injustice to any one. Before the resale, the new Constitution of the state had forbidden the grant of any exemption from taxation; and it was held that the legislature could not authorize a sale with the exemption.[81]

§ 693a. **In the absence of express statutory direction**, or of an equivalent implication by necessary construction, provisions in restriction of the state's power to tax do not pass to a new corporation succeeding by consolidation or by purchase at foreclosure to the property and ordinary franchises of the first grantee.[82]

§ 693b. **Power to fix rates does not pass.** A provision of the charter of a railroad company authorizing it to fix rates on its road is in derogation of the sovereign power of the state to regulate rates, and the immunity does not pass with a sale of its property on foreclosure to its successor. Such an exemption from control is to be classed with an exemption from taxation. It is as vital that the state should retain its control of tolls upon public highways as that it should not surrender or fetter its power of taxation. The right to regulate the rate is a power of the same character, and in the con-

[80] Wilson v. Gaines, 103 U. S. 417. The case of Knoxville &c. R. Co. v. Hicks, 9 Bax. (Tenn.) 442; 15 Am. Railw. R. 197, was commented upon as not being contrary to the above decision, because in that case it was distinctly adjudged that all the privileges and immunities as defined by the charter and laws, and the decree in the cause, passed to and vested in the new company, which was the purchaser.

[81] Trask v. Maguire, 18 Wall. (U. S.) 391.

[82] Norfolk &c. R. Co. v. Pendleton, 156 U. S. 667; 15 Sup. Ct. 413

struction of language conferring such a right the same principles should be applied.[83]

The purchaser of an interstate railway at a judicial sale takes the property subject to the proper regulations and use established by Congress, notwithstanding the mortgage foreclosed may have antedated the legislation.[84]

§ 694. A purchaser at a foreclosure sale of a railroad takes only the property which the decree directed to be sold. He has no claim to a fund which was not ordered to be sold, and which the master did not attempt to sell.[85]

The purchaser at a judicial sale has no right to any part of the earnings of a railroad while it remains in the possession of the receiver after the sale and before its confirmation, while indulgence is extended to the purchaser in making the required payments. The road in the mean time is in the custody of the receiver, and its earnings belong to the bondholders. The Iowa court has laid down a different doctrine in deciding that a judgment against a receiver after his discharge did not bind assets turned over to a new company purchasing at the foreclosure sale. "When it [the purchaser] took title to the property," said the court, "it took the funds in the receiver's hands as well as the right to collect and appropriate what was due him as receiver, as fully as it took title to the railway itself. True, its right to the fund in the receiver's hands was subject to the right of the court appointing him to appropriate so much of the same as might be necessary in liquidation of the indebtedness of the receivership; but in all other respects, and as to all other persons, the title was absolute in the company. . . ."[86]

The purchaser cannot retain from his bid at a judicial sale a sum sufficient to pay taxes which have become a lien upon the property. The lien for taxes does not stand on the footing of an ordinary in-

[83] Road Co. v. Sandford, 164 U. S. 579; 17 Sup. Ct. 202; Matthews v. Commissioners, 97 Fed. 400.

[84] Union Pac. R. Co. v. Mason City &c. R. Co. 199 U. S. 160; 26 Sup. Ct. 19.

[85] McLeary v. Dawson, 87 Tex. 524; 29 S. W. 1044.

[86] Brockert v. Iowa Cent. R. Co. 93 Iowa, 132; 61 N. W. 405. See, also, Winter v. Iowa Cent. R. Co. 111 Iowa, 342; 82 N. W. 760.

cumbrance, but attaches to the *res;* and the purchaser, in the absence of any agreement, takes the property subject to such lien.[87]

Where purchasers organize a new company and take possession of the assets of the old company and agree to account for book debts, they are not liable for book accounts they are unable to collect, there being no guaranty of collection. Where tools appraised as personal property turn out to be in fact fixtures, the new company is entitled to have the value of such property deducted from the appraisement of the personal property for which it agreed to pay.[88]

§ 694a. Where during foreclosure suit, an illegal tax is paid and its payment is approved by the court, purchasers of the railroad who are parties to the suit cannot recover the tax as illegally levied. The sale, by authority of statute, passed to the purchaser all the works and property of the company, and all other property "other than debts due to it." This language precludes any claim to have the tax refunded to the purchaser, the tax in question being no part of the proceeds of the sale, nor in the hands of the receiver.[89]

II. *Organization of Purchasers into a New Corporation.*

§ 695. Whether individual purchasers can manage the property as individuals.—When a corporation is expressly authorized to mortgage its franchise and corporate property upon a foreclosure of such mortgage, the franchise and property of the first corporation pass into the possession and management of the mortgagee or of the purchaser subject to the like legislative control as the first, and subject to the public right to require a continuous use of the chartered powers of the corporation; but whether an individual acquiring such property through a foreclosure could hold and manage it as an individual, or whether it would be necessary to form a corporation with the powers and duties of the original corporation, would depend upon the terms of the statute authorizing such mortgage,

[87] Osterberg v. Union Trust Co. 93 U. S. 424; Terre Haute &c. R. Co. v. Harrison, 96 Fed. 907.

[88] Huston v. Clark, 162 Pa. St. 435; 29 Atl. 866, 868.

[89] Norfolk &c. R. Co. v. Supervisors, 87 Va. 521; 12 S. E. 1009.

or upon the general laws and policy of the state in relation to this matter. Aside, however, from statutes authorizing or requiring the purchasers to organize themselves into a corporation for the purpose of enjoying the property, it would seem in general that public policy would require an organization into a corporation. The laws granting the privilege of operating railroads, and regulating the management of them, are framed solely with reference to corporate bodies. Moreover, it is the universal custom to manage all such enterprises through the instrumentality of a corporate organization; and such an organization is so advantageous to the owners that there is no wish or attempt to manage it in any other manner. Practically it is impossible for a numerous body of part owners, widely scattered, and varying from time to time in personal composition, to operate a railroad. Where there are no general statutes authorizing purchasers to form a corporation for the purpose of using the property, they should obtain a special act of incorporation.

§ 696. There is some authority to the effect that the corporate existence continues after a foreclosure sale, and that the purchasers become in effect new stockholders, and may complete a reorganization of the corporation with all its franchises and powers. It is immaterial in such case whether the foreclosure be by sale under judicial process, or under a power contained in the mortgage; but of course the mortgage must have been made by legislative authority. The purchasers and their reorganized corporation take the property relieved from liability for debts not creating a prior incumbrance on it.[90]

But the general doctrine is that a mortgage of franchises confers no right upon purchasers at foreclosure sale to exist as the same corporation. At most the purchasers have the right to reorganize as a new corporation, subject to the laws existing at the time of reorganization.[91]

§ 697. The legislature has full power to authorize the bondholders, for whom the mortgaged property had been purchased at a

[90] Gulf &c. R. Co. v. Morris, 67 Tex. 692, 700; 4 S. W. 156, per Stayton, J.

[91] Norfolk &c. R. Co. v. Pendleton, 156 U. S. 667; 15 Sup. Ct. 413.

foreclosure sale, to reorganize as a new corporation, with the rights of the old corporation;[92] and when, with the acquiescence of the majority of bondholders of the old corporation, a new corporation has been formed under authority of the state, this corporation becomes a new instrumentality for carrying into effect the original purpose in creating the first corporation, and a minority of the bondholders have no rights that can be asserted as against such action. In applying the trust property to the purposes of the original public trust, no rights of an individual bondholder are impaired, so long as such bondholder retains his original pro rata interest in the property. Each bondholder, moreover, in becoming such, entered into a contract relation with each and all of his co-bondholders. His right to appropriate the security in satisfaction of his bond, in such lawful manner as he may choose, is modified by the same existent right in every other holder. His absolute right of control is limited not only by the express provisions of the bond and mortgage, but also, in great measure, by the peculiar character of the security.[93]

Where the purchasers at foreclosure sale of railway property and franchises organize a new company under authority of the general statute, an existing law in relation to farm crossings is to be taken as a part of its charter.[94]

§ 698. Statutory provisions for incorporating purchasers.—At the present time, however, there are statutes in many of the states framed for the especial purpose of enabling purchasers of railroads at foreclosure and execution sales to become a corporation immediately upon obtaining possession of the property, without any uncertain interval before such organization can be obtained under special acts; or, as some statutes provide, the purchaser has all the du-

[92] Gates v. Boston &c. R. Co. 53 Conn. 333; 5 Atl. 695.

[93] Gates v. Boston &c. R. Co. 53 Conn. 333; 5 Atl. 695, per Stoddard, J. In conclusion the learned judge said: "There is no reason why, subject to legislative and judicial control and direction, the majority in interest in common property of indivisible nature, consecrated to public use, should not so use that property as to advance the private interests in that property and secure the public welfare." See, in connection with the last case, Middletown v. Boston &c. R. Co. 53 Conn. 351; 5 Atl. 706.

[94] Alabama &c. R. Co. v. Odeneal, 73 Miss. 34; 19 So. 202.

ties and the powers and rights relative to the maintenance and operation of the railroad which pertained to the mortgagor corporation[95]

[95] **Alabama**: Code 1866, §§ **1596–1598, 2052**; Code 1896, §§ **1181–1183**. Under this act the right of purchasers at a judicial sale to organize a new corporation is not limited to the first or immediate purchasers at such sale, but embraces sub-purchasers as well. Birmingham R. &c. Co. v. Birmingham Traction Co. 128 Ala. 110; 29 So. 187.

Arkansas: Dig. of Stats. 1884, §§ **5455–5457**; 1894, § **6178**.

Connecticut: G. S. 1902, § **3818**; L. 1897, ch. 88, § **1**.

Florida: Dig. of Laws 1881, p. 259; R. S. 1892, § **2241**; G. S. 1896, § **2803**, art. 10.

Georgia: Code 1882, § **1689** (v); Code 1895, § **2167**, arts. 11, 12; § **2168**.

Illinois: 2 Annot. Stats. 1885, p. 1907; R. S. 1905, ch. 114, § **1**; L. 1877, p. 163.

Indiana: 2 R. S. 1888, §§ **3937, 3938, 3946**; Burns' Annot. Stats. 1901, vol. 2, § **5210**. The statute implies that the new company is not liable for the debts of the old unless it assumes them. Lake Erie &c. R. Co. v. Griffin, 92 Ind. 487; Midland R. Co. v. Fisher, 125 Ind. 19; 24 N. E. 756.

Iowa: Code 1880, § **1086**; Code 1897, § **1634**. State v. Iowa C. R. Co. 83 Ia. 720; 50 N. W. 280.

Kansas: Comp. Laws 1885, ch. 84, §§ **51, 5225**; G. S. 1899, § **5689**.

Kentucky: G. S. 1881, pp. 957, 1004; Carroll's Stats. 1903, § **563**.

Louisiana: Const. & R. L. (Wolff) 1904, vol. 2, p. 1490, § **3**.

Maine: R. S. 1883, ch. 51, §§ **93, 94, 105–107**; R. S. 1903, ch. 52, § **56**.

Maryland: Pub. Gen. Laws 1888, art. 23, § **187**; 1904, §§ **275, 276**.

Massachusetts: Acts 1886, ch. 142; R. L. 1902, ch. 111, § **74**. Chadwick v. Old Colony R. Co. 171 Mass. 239; 50 N. E. 629.

Michigan: 1 Annot. Stats. 1882, §§ **3314, 3351**; Comp. Laws 1897, vol. 2, § **6224**.

Minnesota: G. S. 1878, ch. 34, § **87**; Stats. 1894, vol. 1, § **2727**.

Mississippi: Laws 1877, ch. 46; Laws 1878, ch. 112; R. Code 1880, § **1038**; Code 1906, § **910**.

Nebraska: Comp. Stats. Annot. pp. 1162, 1163.

Nevada: Stats. 1901, p. 51.

New Jersey: 2 R. S. 1877, p. 944, § **165**; Supp. 1888, p. 844, § **86**; G. S. 1895, vol. 2, p. 2676, § **167**.

New Mexico: Comp. Laws 1897, §§ **3922–3925**.

New York: 3 R. S. 1889, pp. 1781, 1787, 1791; Bliss Annot. Code 1902, p. 2641c; Heydecker's G. L. 1901, vol. 3, p. 3302, § **77**. These acts do not prevent a sale to an existing corporation capable of holding the property and exercising the franchises. People v. Brooklyn &c. R. Co. 89 N. Y. 75. Under the third section of this act, a stockholder may at any time within six months after the organization of the new corporation, on complying with the terms, and conditions, be entitled to the benefits of the plan of organization; but he has no rights after the lapse of such time. The rights of stockholders are absolute-

at the time of the sale. Although these statutes are important, only a reference can be made to them in a note.

ly barred and cut off by the foreclosure and sale except as preserved by the plan of reorganization. Vatable v. New York &c. R. Co. 96 N. Y. 49. In the same case, when before the Supreme Court in 1881, it was held that, if the plan of organization itself contemplates the limitation of the time within which the stockholders might accept it, and no time was actually fixed as contemplated, the statutory limitation of six months does not apply, and the new organization has no power to limit the time. 9 Abb. N. C. 271. For other phases of the same case see, also, 11 Abb. N. C. 133.

North Carolina: Revisal 1905, vol. 1, § **2552**, Code 1883, ch. 49, § **1936**.

North Dakota: R. C. 1895, § **2947**, art. 11.

Ohio: Bates Annot. Stats. vol. 2, §§ **3426** a, b; 1 R. S. 1880, §§ **3393–3399**.

Oklahoma: R. S. 1903 (Wilson), vol. 1, § **1023**.

Pennsylvania: Pub. Laws 1867, p. 28; Stat. Law of Corporations (Whitworth & Miller), 1187.

South Carolina: Code of Laws 1902, vol. 2, § **2042**; G. S. 1882, §§ **1420–1424**.

South Dakota: R. C. (Hipple Ed.) 1904, p. 642, § **472**.

Tennessee: Code of 1896, p. 430, §§ **1513**, **1514**; Code 1884, § **1253**.

Texas: Sayles' Civil Stats. vol. 2, 1897, §§ **4549–4555**; Paschal's Digest, 1866, p. 820, arts. 4912, 4916. See, as to construction of this statute, Witherspoon v. Texas Pacific R. Co. 48 Texas, 309.

Utah: Comp. L. 1888, vol. 2, § **2573**.

Vermont: Stats. 1894, p. 708, § **3965**; R. L. 1880, §§ **3461–3475**.

Virginia: Code 1904, vol. 1, § **1294b**; Code 1887, § **1233**.

Washington: Hills Stats. vol. 2, § **626**.

West Virginia: Code Annot. 1906, § **2383**; Code 1887, ch. 54, §§ **72**, **73**.

Wisconsin: Stats. Suppl. 1906, vol. 3, § **1788**; R. S. 1878, § **1828**. See Wells v. Green Bay & M. C. Co. 90 Wis. 442.

CHAPTER XXII.

PROCEEDINGS IN BANKRUPTCY AND INSOLVENCY AGAINST COMPANIES: §§ 699-709.

§ 699. The Bankruptcy Act of 1898 applies to corporations engaged in certain enumerated lines of business, namely, in "manufacturing, trading, printing, publishing, mining, or mercantile pursuits." The occupation of common carriers is not among those provided for, and hence the Act does not apply to railroad companies. Furthermore, it has been held that the act does not apply to a corporation engaged in building railways,[1] or acting as a common carrier of passengers and goods.[2]

§ 699a. Railroad companies were within the operation of the Bankruptcy Act of 1867, which in terms was made to apply "to all moneyed, business, or commercial corporations and joint stock companies."[3] It provided that like proceedings may be had and taken as are provided in the case of other debtors, either "upon the petition of any officer of such corporation or company, duly authorized by a vote of a majority of the corporators at any legal meeting called

[1] Minnesota Const. Co. In re, 60 Pac. 881.

[2] Phila. & L. Trans. Co. In re, 114 Fed. 403.

[3] Winter v. Iowa &c. R. Co. 2 Dill. (U. S.) 487; 7 N. B. Reg. 289, 291; California Pacific R. Co. In re, 3 Sawyer (U. S.), 240; Sweatt v. Boston &c. R. Co. 3 Cliff. (U. S.) 339; 5 N. B. Reg. 234; Alabama &c. R. Co. v. Jones, 5 N. B. Reg. 97; Adams v. Boston &c. R. Co. 4 N. B. Reg. 314; Factors' &c. Co. v. Murphy, 111 U. S. 738; 4 Sup. Ct. 679; New Orleans &c. R. Co. v. Delamore, 114 U. S. 501; 5 Sup. Ct. 1009.

for the purpose, or upon the petition of any creditor of such corporation or company." But no discharge could be granted to such corporation or company, or to any officer or member of it.[4] The constitutionality of this act, as applied to persons other than merchants or traders, has been called in question, on the ground that at the time of the adoption of the Constitution the English system of bankrupt laws was limited to such persons, and therefore it was argued that the grant to Congress of the power to establish uniform bankrupt laws must be construed as limited to the making of a bankrupt law which should apply only to the same persons. But this limitation in the English system is a mere matter of policy, and by no means enters into the nature of such laws.[5] This question of constitutionality is, however, no longer open to discussion.[6]

Railroad and other private corporations were also, like natural persons, severally subject to compulsory proceedings in insolvency under the state insolvent laws,[7] or could voluntarily take advantage of such laws.[8]

A decree of a court having jurisdiction adjudging a corporation could only be assailed by a direct proceeding in a competent court, unless it appeared that the decree was void in form, or that due notice of the petition was never given.[9]

§ 700. The Bankruptcy Act not inapplicable to corporations on the ground that it provides no discharge for them. It has also been objected that the Bankrupt Act of 1867 was unconstitutional so far as it applied to corporations, because it denied to them the right in any case to obtain a discharge. But it has never been decided that

[4] Bankrupt Law, § 5122, R. S. of U. S.; Bump's Law of Bankruptcy, 10th ed. 791.

[5] Story Com. Const. § 1113.

[6] California Pacific R. Co. In re, 3 Sawyer (U. S.), 240.

[7] Platt v. New York &c. R. Co. 26 Conn. 544.

[8] The Insolvent Act of Massachusetts, from which the National Bankrupt Act was for the most part taken, applies to all corporations of the state except railroad and banking companies. G. S. 1860, ch. 118, § 113. A street railway company could not be subjected to proceedings under this act. Central Nat. Bank v. Worcester &c. R. Co. 13 Allen (Mass.), 105.

[9] Lamp Chimney Co. v. Brass & Copper Co. 91 U. S. 656; Graham v. Boston &c. R. Co. 118 U. S. 161; 6 Sup. Ct. 1009.

"a law on the subject of bankruptcy, within the meaning of the Constitution, must provide for the discharge of all persons subject to its provisions." Mr. Justice Hoffman, of the District Court of the United States for California,[10] in overruling this objection, said: "The books contain about forty reports of such cases in the District and Circuit Courts, and in the Supreme Court of the United States. In no one has the objection I have been considering been noticed. I do not claim that this general acquiescence in the validity of the law has the authority of an express judgment on the point; but surely such a tacit admission and consent, *semper ubique et ab omnibus,* are entitled to great weight in determining a doubtful question of constitutional construction, even conceding this question to be such."

Inasmuch as a bankrupt corporation cannot be discharged, the provision of the bankruptcy law, prohibiting a creditor who has proved his debt from maintaining a suit therefor, did not apply as against a creditor of such corporation.[11]

§ 701. Authority to present a petition in behalf of the corporation.—In bankruptcy proceedings against the Alabama and Florida Railroad Company, it was objected that no officer of the company had been duly authorized by a vote of the majority of the corporators present at a legal meeting called for the purpose to present any petition for adjudication of bankruptcy. The Circuit Court of the United States held, however, that the proceedings were regularly instituted, since, if any irregularity occurred in the call for the stockholders' meeting, by which the direction was given to institute the proceedings, it arose from the contumacy of certain directors, who resigned their offices for the purpose of embarrassing the stockholders. The city of Pensacola owned more than five-sevenths of the stock of the company, and it was sufficiently clear that the city authorities took all practicable measures for having a fair stockholders' meeting and vote on the subject; and that the vote of the city was positive in favor of the bankruptcy proceedings, and of the instruction to the president of the railroad company to institute them.[12]

[10] California Pacific R. Co. In re, 3 Sawyer (U. S.), 240.

[11] Birmingham Nat. Bank v. Keck, 55 How. Pr. (N. Y.) 222.

[12] Davis v. Railroad Co. 1 Woods, 661, per Bradley, Circuit Justice.

The provisions in regard to authorizing proceedings in bankruptcy applied only to voluntary proceedings. No vote of the corporators was necessary to authorize counsel to appear for a corporation and consent to an adjudication of bankruptcy, or to admit acts of bankruptcy when involuntary proceedings against it have been commenced by a creditor. In such case the usual course was adopted, and the case proceeded as in ordinary cases when legal measures are instituted against corporations. They had the power to appear by counsel, and counsel had the power to admit facts and to bind corporations in the same manner as they do in other suits.[13]

Upon the filing of a petition in bankruptcy against a railroad company by creditors the court had authority to inquire into the value of securities held by the petitioning creditors and others, in order to ascertain whether the petitioners held provable claims to the amount required by the Bankrupt Act.[14]

Service of the petition in bankruptcy upon a corporation was made personally, by delivering a copy of the petition and order to show cause to its head or principal officers, or by leaving the order at the principal place of business of the corporation, which, within the meaning of the law, was its "usual place of abode."[15]

§ 702. After bankruptcy proceedings had been commenced against a railroad corporation in one of two states in which it had a place of business, and under the laws of which it was chartered, these proceedings were allowed to proceed to their final conclusion without the interference of the District Court of the other state. The Boston, Hartford and Erie Railroad Company was chartered by the State of Connecticut, and afterwards received a grant of corporate privileges from the State of Massachusetts. The company was adjudged bankrupt in the latter state, and subsequently proceedings in bankruptcy were commenced in Connecticut. The creditor on whose petition the adjudication had been made in Massachusetts petitioned the District Court in Connecticut, alleging that the proceedings in Connecticut were collusive, and would prejudice the

[13] Leiter v. Republic F. Ins. Co. 7 Biss. (U. S.) 26.

[14] California Pacific R. Co. In re, 3 Sawyer (U. S.), 240; Osage Valley &c. R. Co. In re, 9 N. B. R. 281.

[15] California Pacific R. Co. In re, 3 Sawyer (U. S.), 240.

creditors of the company, and embarrass the settlement of the estate, and praying to be allowed to appear and defend against the petition, and for further relief.

This petition was dismissed by the District Court in Connecticut, which proceeded to adjudicate the corporation bankrupt. Upon a petition of review the Circuit Court of the United States held that this petition should have been entertained; that the facts set forth warranted the creditor's intervention, and that the District Court for Massachusetts should be permitted to exercise the jurisdiction it had acquired, and that the proceedings in the District Court for Connecticut should be stayed.[16]

Whether the bankrupt company was to be regarded as a single corporation, or as two corporations united in interest, having one and the same corporators, the same creditors, and the same property, the District Court for Massachusetts, having first acquired jurisdiction of the case, should be permitted to retain jurisdiction until the proceedings should be closed. The proceedings in the District Court for Connecticut need not be necessarily dismissed; but if not dismissed, must be stayed.

Whether the insolvency courts of a state have jurisdiction of a consolidated corporation formed in part of railroad companies originally organized under the laws of other states, the consolidation

[16] Boston &c. R. Co. In re, 9 Blatchf. (U. S.) 101, 109. Judge Woodruff, delivering the opinion of the court, said: "I am of opinion that, in the absence of any express provision, it would be the duty of the other district courts to yield the control and direction of the entire proceeding to that one whose jurisdiction was first invoked, and whose power is ample to accomplish all the purposes of the law, and protect the rights of all parties interested, under the authority of the same act which governs each of them. Without this, it is difficult to see how the law can be safely, uniformly, and legally administered. On the appointment of an assignee, all the property of the bankrupt is, by express terms, vested in him by the assignment made, and such assignment relates back to the commencement of the proceedings. When, therefore, one court, having jurisdiction, has adjudged a debtor a bankrupt, appointed an assignee, and executed the assignment, nothing of the property of the bankrupt remains to him to be taken or administered by another tribunal. All is vested in the assignee appointed by the other, as of the time when the first petition was filed."

having been effected by concurrent legislation of the several states in which the entire line of road was located, is a different and more difficult question.[17] It would seem that such courts would have no jurisdiction of the companies organized in other states, and holding property in them by virtue of such organization, except so far as these courts could reach the property and franchises in other states through the jurisdiction and control of the courts over the officers of the consolidated company.

§ 703. **All the franchises of a railroad corporation that are transferable passed to the assignee under the assignment.** The franchise to be a corporation is not transferable, and does not pass to the assignee, and he cannot pass it to a purchaser at a bankruptcy sale; but a grant by a municipal corporation to a railway company, of a right of way through certain streets of the city or town, is a franchise which passes to the assignee in bankruptcy, and may be sold by him as an essential part of the road.[18]

§ 704. **A railroad company was not a "banker, broker, merchant, trader, manufacturer, or miner,"** within the terms of the former Bankruptcy Act, providing that the fraudulent stopping of payment by any person included in any one of these classes, or the stopping or suspension and non-resumption of payment by any person included in any of these classes of his commercial paper for fourteen days, though not fraudulent, should be acts of bankruptcy.[19]

§ 705. **Whether precedence should be given to foreclosure suits or to proceedings in bankruptcy** depends upon the discretion of the court in view of the circumstances of the case. The Lake Superior Ship Canal, Railroad and Iron Company having executed four successive mortgages of its canal and property, the trustee under the first mortgage filed a bill in equity in the Circuit Court of the United States for the Eastern District of Michigan to foreclose the mortgage, and to this bill the company and the subsequent mortgagees were

[17] See Platt v. New York &c. R. Co. 26 Conn. 544.

[18] New Orleans &c. R. Co. v. Delamore, 114 U. S. 501; 5 Sup. Ct. 1009.

[19] Winter v. Iowa &c. R. Co. 2 Dill. (U. S.) 487.

made parties. A receiver was appointed in this suit, and authority given him to create an indebtedness which should be a first lien upon the property. The second and third mortgagees soon afterwards filed bills in the same court to foreclose these mortgages, without first obtaining leave of court. The mortgagor was then adjudged bankrupt and assignees appointed, who by supplemental bills were made parties to the several foreclosure suits. Subsequently the trustee under the fourth mortgage filed a bill to foreclose that mortgage in the Bankruptcy Court. The assignees objected to the maintenance of the suits by the subsequent mortgagees, because they were already impleaded in the suit on the first mortgage, and their rights could be adjusted in that suit; and moreover, the amount of the prior lien being in doubt, and having been put in issue by the pleadings, it would be impossible to make a proper decree under either of the subsequent bills. The assignees therefore filed an original bill in the Circuit Court, which had for its object a sale of the mortgaged premises free of liens and the ascertainment of the rights of the various parties interested in the proceeds, and their distribution accordingly. The proceedings in the foreclosure cases were stayed. The question then arose whether the foreclosure suits should be permanently stayed, or whether the equities of the parties should be worked out in those suits, or some one of them.[20]

In regard to the subsequent foreclosure suits the court was of opinion that they should not be prosecuted without leave of court, and that such leave should not be granted, inasmuch as the relief sought could be had in the pending litigation. A strong preference was expressed for continuing the working of the causes in the hands of the mortgagees, whose interests were greater than those of the assignees; and for making the suit on the first mortgage the means of working out the rights and remedies of all parties.

The court, however, declared its power to order all matters pending in the several foreclosure suits in that court to be adjudicated in an original suit, commenced in that court by the assignees in bankruptcy: that it was a question of practice and convenience whether the court would take the one course or the other. The court might also entertain a bill by the assignees in bankruptcy against the sev-

[20] Sutherland v. Lake Superior R. &c. Co. 1 Cent. Law Jour. 127; 9 N. B. R. 298, 307.

eral lien-holders to ascertain the amounts due, and to sell the property free of incumbrances. The power exercised in the Court of Bankruptcy to sell mortgaged property free from all incumbrances is but an instance of the exercise of a power familiar to a court of chancery.[21]

§ 706. The Bankruptcy Court had no authority to take property out of the possession of a receiver appointed under order of a state court in chancery, in proceedings for foreclosure previous to the commencement of proceedings in bankruptcy. The possession of the receiver in such case is the possession of the mortgagees, and cannot be interfered with without liquidating the debt. The trustees of the first mortgage of the Alabama and Florida Railroad Company, on the first day of June, 1867, filed a bill to foreclose it in a county court of the State of Florida, and on the eleventh day of the following month a receiver was appointed, who took possession of the railroad and mortgaged property. Two days after the appointment of the receiver the company, by its officers, filed a petition in bankruptcy, and was adjudged bankrupt by the District Court of the United States for the Northern District of Florida, and subsequently an assignee was appointed. On his application the District Court ordered the mortgaged property to be taken out of the hands of the receiver and delivered to the assignee, by the United States marshal. Afterwards, in February, 1868, the same court ordered the property to be sold as perisable property. The sale took place on the twenty-fifth day of March following, the trustees of the mortgage giving public notice that they claimed the proceedings to be illegal. The purchasers of the road organized a new corporation under the name of the Pensacola and Louisville Railroad Company. The trustees and receiver then filed a petition in the Circuit Court of the United States for a revision of the proceedings of the District Court. The circuit justice, Mr. Bradley, made a decree declaring the taking of possession of the property by the assignee to be illegal, and setting aside the order of the District Court requiring the receiver to surrender the property. The question whether the sale in bankruptcy should be set aside was reserved, and after argument was

[21] See, also, Ellis v. Boston &c. R. Co. 107 Mass. 1, 32.

now decided; the sale being set aside, and the purchase money paid to the assignee ordered to be returned.[22]

§ 707. For what amount a holder of bonds as collateral could prove.—When a company had pledged its own mortgage bonds for a debt of a less amount, upon a winding up of the company, the holder was entitled to receive dividends on the whole amount expressed to be secured by the debentures *pari passu* with the holders

[22] Davis v. Railroad Co. 1 Woods (U. S.), 661, 665. Mr. Justice Bradley, delivering the opinion of the court, said: "The respondents' assignee contended that the sale should stand although the order of sale was illegal. I do not think so in such a case as this. It is analogous to that of a sale by a sheriff on execution against A. of property belonging to B. The sale is void. The owner may recover his property of the purchaser. So may the trustees in this case. They ought not to be compelled to take the proceeds arising from the unlawful sale. Their rights might, in this way, be wholly sacrificed. . . . The question then arises as to the disposition to be made of the purchase money paid, or secured to be paid, by the respondents. The purchasers insist that it should be returned; the assignee, that it should be retained by him for the benefit of the general creditors. From an examination of the evidence it seems clear that the assignee assumed to sell the property clear of the mortgage. He did not profess to sell the mere equity of redemption. The respondents in their answer claim that the sale was made free from the lien of the mortgage. They claim that the mortgage was void. And whilst it is true that the petitioners gave notice at the time of the sale that it would be subject to their lien, the assignee and the purchasers did not act on this view. The latter never intended to purchase subject to the lien, but clear of the lien. Had the receiver sold the property subject to the lien of the first mortgage, the amount bid for it by the respondents would have been payable by them, and would have been a proper asset of the bankrupt company's estate. But as they did not sell it in that manner, but sold it as unincumbered property, so far as the first mortgage was concerned, and as that was a clear mistake, since the first mortgage was a valid lien and absorbed the entire property, the sale ought to be held invalid, and the proceeds of the sale ought to be returned to the purchasers. This is clearly the justice of the case, and in my judgment the law is contrary thereto." See, also, Sutherland v. Lake Superior R. &c. Co. 1 Cent. L. J. 127; 9 N. B. Reg. 298, 307; Myer v. Crystal Lake &c. Works, 14 N. B. Reg. 9; Freeman v. Fort, 46 N. B. Reg. 9; High Receivers, §§ 52, 53. But see, contra, Merchants' Ins. Co. In re, 3 Biss. (U. S.) 162.

of the other debentures; but of course was not to receive more in the whole than what was due upon the original debt with interest.[23] The debenture holder could not otherwise reach his share of the property mortgaged, as to which he had priority over other creditors.[24]

A creditor holding the guaranty of a third person could prove his claim in full against the principal debtor without surrendering the guaranty.[25] The dividend received in respect to the amount guaranteed went to reduce the claim against the guarantor.[26]

§ 708. **Fraudulent mortgagees allowed to prove their actual advances as an unsecured debt.**—A mortgage given by a railroad company to an association organized as a corporation whose declared object was "the completion and ownership" of such railroad, and of which association the president and vice-president of the railroad company were secret members, was held to be constructively fraudulent by reason of the trust relations between the parties to it, and in view of the effect on the company and its creditors of giving judicial sanction to the transaction; but upon the bankruptcy of the railroad company the association was allowed to prove the amount actually advanced by the association in money to the company as an unsecured debt.[27]

§ 709. **Bankruptcy proceedings against a railroad company should be dismissed** when its stockholders have in good faith purchased nearly all the floating debt of the company, and are willing to give proper security for the payment of the balance of such indebtedness. It being evidently for the best interest of all parties, and the desire of a large majority, that the corporation shall be managed by its own officers, the court will not retain the custody and control of its property in order to assist a few objecting creditors to coerce their claims. For such purposes the Bankruptcy Court has full equitable jurisdiction.[28]

[23] Regent's Canal Iron Works Co. In re, L. R. 3 Ch. D. 43; Jerome v. McCarter, 94 U. S. 734, 740.

[24] Per Colt, J., in Third Nat. Bank v. Eastern R. Co. 122 Mass. 240.

[25] Anderson, In re, 7 Biss. (U. S.) 233.

[26] Raikes v. Todd, 8 Ad. & El. 846.

[27] Kappner v. St. Louis &c. R. Ass'n, 3 Dill. (U. S.) 228.

[28] Indianapolis &c. R. Co. In re, 5 Biss. (U. S.) 287.

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